Supreme Court, U.S.
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No. 02-

IN THE

Supreme Court of the United States

CORE COMMUNICATIONS, INC.,
Petitioner,

v.

FEDERAL COMMUNICATIONS COMMISSION AND THE UNITED STATES OF AMERICA,
Respondents.

On Petition for Writ of Certiorari to the
United States Court of Appeals
for the District of Columbia Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

1. Whether the court of appeals' remand, without *vacatur*, of Federal Communications Commission rules held to have been promulgated without statutory authority contravenes the Administrative Procedure Act and this Court's precedent constraining agency power to that delegated by Congress.

LIST OF PARTIES AND AFFILIATES

Pursuant to Supreme Court Rule 29.6, Petitioner states as follows:

Core Communications, Inc. (CoreTel) is a closely held corporation organized under the laws of the District of Columbia. CoreTel has no parent companies, subsidiaries, or affiliates, and no publicly held company has an ownership interest in it. CoreTel participated in the proceedings below before the Federal Communications Commission (FCC) and was an intervenor in support of the petitioner in the court of appeals. WorldCom, Inc. was the petitioner. The FCC and the United States were respondents. Other intervenors in support of petitioners were: e.spire Communications, Inc., People of the State of New York, Time Warner Telecom, Inc., Public Service Commission of Maryland, National Association of Regulatory Utility Commissioners, California Public Utilities Commission, New York Public Service Commission, KMC Telecom Holdings, Inc., RCN Telecom Services, Inc., Wireless World, LLC, Level 3 Communications, LLC, Sprint Corporation, Association of Communications Enterprises, Starpower Communications, LLC, Competitive Telecommunications Association, Internet Access Coalition, Global NAPS, Inc., Pac-West Telecom, Inc., ICG Communications, Inc., Public Utilities Commission of Ohio, United States LEC Corp. and Focal Communications Corporation. Intervenors in support of the FCC and the United States were BellSouth Corporation, SBC Communications, Verizon Telephone Companies (including Verizon Minnesota, Verizon South Systems, Verizon Alaska, Verizon Arkansas, Verizon Midwest, Verizon California, Verizon Delaware, Verizon Florida, Verizon Hawaii, Verizon Maryland, Verizon New England, Verizon New Jersey, Verizon New York, Verizon North, Verizon Northwest, Verizon Pennsylvania, Verizon Washington, DC, Verizon West Coast, Verizon Southwest, and Verizon West Virginia),

Qwest Corporation, AT&T Wireless Services, Inc., and Micronesian Telecommunications Corporation.

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PETITION FOR WRIT OF CERTIORARI

Core Communications, Inc. (CoreTel) respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the District of Columbia Circuit.

OPINIONS BELOW

The opinion of the court of appeals, reproduced in the Appendix to this Petition (Pet. App.) at 1a-9a, is reported at 288 F.3d 429 (D.C. Cir. 2002). The order of the Federal Communications Commission, *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996; Intercarrier Compensation for ISP-Bound Traffic* in CC Docket Nos. 96-98 and 99-68, is reported at 16 FCC Rcd. 9151 (2000) (Pet. App. 14a-37a). The FCC order is commonly referred to as the "*ISP Remand Order*" because it was issued pursuant to the D.C. Circuit's first reversal of the

FCC's attempt to regulate intercarrier compensation in *Bell Atlantic Tel. Cos. v. FCC*, 206 F.3d 1 (D.C. Cir. 2000).

JURISDICTION

The court of appeals' decision in *WorldCom* was released May 3, 2002. The court of appeals denied CoreTel's petition for rehearing on September 24, 2002. *See* Pet. App. 10a-11a. This petition is timely filed by operation of Rule 13, which provides 90 days to request certiorari after entry of an order denying discretionary review. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

Section 251(b)(5) of the Telecommunications Act of 1996, 47 U.S.C. § 251(b)(5), appears at Pet. App. 12a. Section 706(2)(C) of the Administrative Procedure Act, 5 U.S.C. § 706(2)(C), appears at Pet. App. 13a.

STATEMENT

The *ISP Remand Order* represents the second failed attempt by the Federal Communications Commission (FCC) to establish a national policy governing the payments, known as "intercarrier compensation," owed to local telecommunications carriers that terminate Internet calls on their networks. For the second time in two years, the court of appeals reversed the agency, holding that the FCC had no statutory authority to promulgate regulations restricting intercarrier compensation for calls made to Internet Service Providers (ISPs). Nonetheless, the court of appeals remanded the rules to the FCC, despite never reaching their substantive validity, *without* vacating the agency's decision on the merits.

The Court's intervention in this case is warranted because the standard for *vacatur* employed by the D.C.

Circuit is inconsistent with the Administrative Procedure Act and this Court's precedent on agency authority. The court of appeals' decision provides no judicially manageable standards for determining whether an agency's unlawfully promulgated regulations should be vacated or, instead, merely remanded for reconsideration. Although this petition involves solely a question of administrative procedure, it is exceptionally important in view of the dominant role of the D.C. Circuit in our system of administrative law and the extreme practical significance of the judicial remedy for agency regulations reversed on appeal.

1. A brief synopsis of the agency proceedings and substantive decisions on intercarrier compensation may assist the Court in understanding the context of the FCC's order. The Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56, *codified at* 47 U.S.C. § 251 *et. seq.* (West 2000) (1996 Act), fundamentally changed the telecommunications industry by enabling competitive ownership of facilities used to provide local telecommunications services. *AT&T Corp. v. Iowa Utilities Bd.*, 525 U.S. 366 (1999). In creating this new framework, however, Congress preserved existing regulatory requirements, flowing from constitutional takings law, that compensation is owed to those whose facilities assist another carrier in serving customers. One of the means by which the 1996 Act preserves this doctrine is through a mechanism called "reciprocal," or "intercarrier," compensation. Section 251(b)(5) of the 1996 Act requires that a telecommunications carrier compensate other carriers that terminate its calls on their networks. This provision applies to all local telecommunications carriers and mandates compensation for every non-toll telephone call.

One of the central questions surrounding intercarrier compensation has been whether ISP-bound traffic, that is phone calls placed to an ISP to establish Internet connec-

tions, are subject to compensation. Many incumbent telephone companies have argued that these "dial-up" calls are not "local" traffic subject to § 251(b)(5), and thus that competitors serving ISPs should not be compensated for terminating such traffic. The FCC has repeatedly addressed this question, and each time has failed to explain why its assumption of authority over this issue is consistent with the 1996 Act.

2. The FCC has reached markedly inconsistent results in its decisions on reciprocal compensation for ISP-bound traffic. In a 1999 Declaratory Ruling, the FCC unequivocally held that § 251(b)(5) does not impose a compensation obligation for ISP-bound calls because such calls are jurisdictionally interstate communications when viewed "end-to-end" (that is, from the user's modem to the Internet). *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996; Intercarrier Compensation for ISP-Bound Traffic*, CC Docket Nos. 96-98, 99-68, 14 FCC Rcd. 3689 (1999). The FCC ruled, however, that state commissions may nonetheless require, and regulate, compensation for ISP-bound calls under § 251(b)(5). *Id.*, 14 FCC Rcd. at 3705.[1]

On appellate review, the Court of Appeals for the D.C. Circuit found that the FCC's Declaratory Ruling lacked

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[1] Until the *ISP Remand Order* at issue in this petition, several states had decided that ISP-bound calls are indeed subject to reciprocal compensation; some states had also issued decisions under their ratemaking authority to regulate the amount and collection of compensation. *E.g.*, *Proceeding on Motion of the Commission to Examine Reciprocal Compensation*, Case No. 99-C-0529, Opinion and Order 99-10 (N.Y.P.S.C. Aug. 26, 1999); *Petition for Declaratory Order of TCG Delaware Valley*, P-00971256, Opinion and Order (Pa. P.U.C. June 16, 1998).

statutory authority and vacated the agency's decision. *Bell Atlantic Tel. Cos. v. FCC*, 206 F.3d 1 (2000) (reprinted at Pet. App. 38a-53a). The court of appeals criticized the FCC for applying the murky "end-to-end" analysis in order to characterize ISP-bound calls as interstate and therefore ourside the scope of § 251(b)(5). *Id.*, 206 F.3d at 6-8 (Pet. App. 47a-50a). This analysis, the court held, did not provide a basis to conclude that ISP-bound calls were within the agency's statutory authority under § 251(b)(5) even if they are "jurisdictionally" interstate.[2]

The court concluded that this underlying error required that the decision be vacated, without regard to the merits of the FCC's decision. "Because the Commission has not supplied a real explanation for its decision to treat end-to-end analysis as controlling, ... we must vacate the ruling and remand the case." 206 F.3d at 8 (Pet. App. 50a). The court of appeals specifically set forth questions in its opinion that required the FCC to tie its analysis on remand to the statutory language in § 251(b)(5). *Bell Atlantic*, 206 F.3d at 9 (Pet. App. 52a-53a). It never reached the substantive challenges by the petitioners to the agency's refusal to preempt state authority over ISP-bound traffic.

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[2] Section 2(b) of the Communications Act divides jurisdiction over telecommunications between the FCC (interstate communications) and the states (intrastate communications). *See, e.g., Louisiana Pub. Serv. Comm'n v. FCC*, 476 U.S. 355, 374 (1986). Although the FCC has some new jurisdiction over local (intrastate) communications under the 1996 Act, as the court of appeals explained the jurisdictional classification of communications traffic does not in itself provide statutory power to regulate reciprocal compensation, even for "interstate" communications. "However sound the end-to-end analysis may be for jurisdictional purposes, the Commission has not explained why viewing these linked telecommunications as continuous works for purposes of reciprocal compensation." *Bell Atlantic*, 206 F.3d at 8 (Pet. App. 50a).

3. In the 2001 *ISP Remand Order*, the FCC issued a stunning, and internally inconsistent, reversal of policy. It concluded that although ISP-bound calls are not local, carriers nonetheless ***could*** collect reciprocal compensation for them. *ISP Remand Order* ¶ 3 (Pet. App. 17a-18a). The order then created a federal intercarrier compensation rate for these calls, as well as a cap on the number of call minutes for which terminating local carriers will be compensated. *Id.* ¶ 8 (Pet. App. 22a-23a). The FCC held that this federal regime preempted all inconsistent state regulation. *Id.* ¶ 82 (Pet. App. 31a-32a). The agency attempted to support this radical policy not through § 251(b)(5), as it had originally tried and to which it was specifically directed on remand, but rather by relying on an obscure provision in § 251(g) that preserves the local market provisions of the *United States v. AT&T* antitrust consent decree until superceded by FCC rules. 47 U.S.C. § 251(g).

Scores of competitive local carriers, among them CoreTel, appealed the *ISP Remand Order* on grounds that it was issued without authority, unlawfully infringed on state regulatory authority, and constituted an unreasoned departure from agency precedent. Jurisdiction in the court of appeals was based on 47 U.S.C. § 402(a) and 28 U.S.C. § 2342(1).

The court of appeals reversed. *WorldCom, Inc. v. FCC*, 288 F.3d 429 (D.C. Cir. 2002); *see* Pet. App. 1a-9a. The court held that the FCC's new reliance on § 251(g) "does not provide a basis for the Commission's action." *Id.* at 434. In other words, the FCC's remand approach had failed to rectify the defects in its prior § 251(b)(5) analysis and had not provided any other valid statutory basis for the regulatory power it asserted. Consequently, the court of appeals did not reach and did not decide any of the many substantive challenges to the rationale for and reasonableness of the agency's new reciprocal compensation rules, *id.* (Pet. App. at 8a-9a), stating

that it was deferring decision on "all issues other than whether § 251(g) provided the authority claimed by the Commission for not applying § 251(b)(5)." *Id.*

Inexplicably, however, the court of appeals merely remanded the *ISP Remand Order* while permitting its new rules to remain intact. The panel opinion explained that *vacatur* of the rules was unnecessary because, although the Commission had failed for a second time to justify its statutory authority over intercarrier compensation, "there is plainly a non-trivial likelihood that the Commission has authority" for its decision. *WorldCom*, 288 F.3d at 434 (Pet. App. 8a). The panel did not address why the Commission's earlier failure of "explanation" in *Bell Atlantic* warranted *vacatur* but a jurisdictional defect in the agency's decision on remand warranted only a further remand to the FCC. Moreover, the court of appeals did not explain why it was an appropriate appellate remedy to permit rules to remain in effect despite the lack of any appellate review of their rationale and record support under the Administrative Procedure Act.

4. Several carriers, including petitioner CoreTel, timely petitioned for rehearing and rehearing *en banc*, arguing that the court of appeals had departed from the settled practice of vacating any agency rule held to be without statutory authority and that the "non-trivial likelihood" standard, even if applicable to decisions reversed due to a failure of reasoned administrative explanation, should not apply to an agency's extra-jurisdictional actions. The court of appeals denied all petitions without opinion on September 24, 2002. (Pet. App. 10a-11a.)

SUMMARY OF ARGUMENT

This case presents an important question of federal law not yet decided by this Court – whether a federal court may permit an administrative agency to enforce rules that it had no statutory authority to promulgate. The issue posed here goes to the very foundation of the limits of agency power and represents a question of administrative procedure that, although rarely discussed, is of utmost practical importance. The court of appeals' approach of merely remanding unauthorized rules if there is "non-trivial likelihood" the agency may later identify a statutory basis for its actions turns the Administrative Procedure Act on its head and is drastically out of step with this Court's judgments on the scope of agency power.

The *WorldCom* decision contravenes fundamental principles of administrative law, as applied in many circuits, and evidences a trend of *ad hoc* appellate review of agency action that bears little respect for Congress's language or intent. This development is particularly troubling from the D.C. Circuit, a court that is the dominant source of administrative jurisprudence simply by virtue of geography. It also raises serious questions of separation of powers by sanctioning unilateral agency decisions on the scope of their own authority. This Court's supervisory oversight is therefore necessary in order to restore consistency to administrative procedure law and to ensure that individual panels of the D.C. Circuit do not continue to issue contradictory, unprincipled decisions that make the remedy for APA reversal turn on the subjective speculation of federal judges.

This petition presents a purely procedural question, but it is an administrative law issue of a type not addressed by this Court in decades. It is also the doctrinal companion to the Court's decision last term in *United States v. Mead Corp.*,

533 U.S. 218 (2001), in which the Court once again grappled with the bounds of agency expertise and judicial deference. This case invites the Court to answer a question not decided, but clearly implied, by *Mead*: whether agency action that exceeds jurisdictional authority must be vacated, without deference to the agency's expertise or reasoning.

REASONS FOR ISSUING THE WRIT

I. THE COURT'S ATTENTION IS REQUIRED TO RESTORE CONSISTENCY TO THE TREATMENT OF AN EXTREMELY IMPORTANT QUESTION OF ADMINISTRATIVE PROCEDURE BY THE COURTS OF APPEALS

The plain language of the Administrative Procedure Act, 5 U.S.C. § 501 *et seq.* (West 2000) (APA) and this Court's "axiomatic" holding in *Bowen v. Georgetown University Hospital*, 488 U.S. 204 (1988), suggest quite directly that a reviewing court must vacate any administrative rule for which the promulgating agency lacks statutory authority. After holding that the FCC had no power to regulate intercarrier compensation for ISP-bound calls, the court of appeals below was obligated to vacate the *ISP Remand Order* in its entirety. The court's formulation of an *ad hoc* test for *vacatur* permits the enforcement of unlawfully adopted agency regulations at the unfettered discretion of reviewing courts, and for that reason warrants this Court's grant of *certiorari*.

A. The Court of Appeals Has Contravened Both The APA and This Court's Holding in *Bowen* In Permitting Enforcement of Unauthorized FCC Rules

1. Congress commands in the APA that federal courts reviewing a challenged agency rule "shall hold unlawful and set aside agency actions, findings, and conclusions found to be in excess of statutory jurisdiction, authority, or limitations, or short of statutory right." 5 U.S.C. § 706(2)(C) (Pet. App. 13a). An agency's jurisdiction lies in the "organic," or "enabling," statute by which Congress created and empowered the agency, in this case the Communications Act of 1934, as amended by the 1996 Act.

It is a bedrock principle of administrative jurisprudence that the sum total of an agency's powers is defined by its enabling statute. Thus, this Court declared in 1988 in *Bowen* that "it is axiomatic that an administrative agency's power to promulgate legislative regulations is limited to the authority delegated by Congress." 488 U.S. at 208 (holding that agencies may adopt retroactive rules only where permitted by statute). Agency action that falls outside the bounds of that limited authority is therefore null *ab initio*. *Id.*; *Louisiana Pub. Serv. Comm'n v. FCC*, 476 U.S. 355, 374 (1986) ("[A]n agency literally has no power to act, let alone pre-empt the validly enacted legislation of a sovereign State, unless and until Congress confers power upon it."); *Lyng v. Payne*, 476 U.S. 926, 937 (1986) ("[A]n agency's power is no greater than that delegated to it by Congress.").

The Court echoed *Bowen* last term in *Mead*, 533 U.S. at 227-228. That case, which focused primarily on refining the parameters of agency statutory interpretation established in *Chevron U.S.A. Inc. v. Natural Resources Defense Council*, 467 U.S. 837, 843-44 (1984), cautioned that deference to

agency expertise has no place unless "the agency's exercise of authority is constitutional, ... and does not exceed its jurisdiction." 533 U.S. at 228, n.6. *See Adams Fruit Co. v. Barrett*, 494 U.S. 638, 649 (1990) ("A precondition to deference under *Chevron* is a congressional delegation of administrative authority."). The implied corollary of this *dictum* is that, where the statutory authority of an agency is at issue – and not merely the agency's reasoning or judgment – judicial deference is inappropriate.

The requirement that agencies remain within the bounds of their authority is not merely formalistic. The Eighth Circuit, for example, has taken the mandate of § 706 of the APA quite seriously, stating that "[a]n agency's promulgation of rules without valid statutory authority implicates core notions of the separation of powers, and we are required by Congress to set these regulations aside." *United States ex rel. O'Keefe v. McDonnell Douglas Corp.*, 132 F.3d 1252, 1255-56 (8th Cir. 1998) (holding that the so-called "Housekeeping Statute," 5 U.S.C. § 301, provides no authority for substantive rulemaking).

2. This case presents a question left unaddressed by this Court last term in *Mead*. If an agency is entitled to no deference in decisions on its jurisdiction, what is the appropriate remedy for a reviewing appellate court where the agency's substantive rules exceed its statutory authority? The court of appeals below crafted from whole cloth a standard that permits agencies to promulgate and enforce rules without regard to the scope of authority granted by Congress. The "non-trivial likelihood" test, 288 F.3d at 434 (Pet. App. 8a), on its face appears directly inconsistent with the presumption in *Mead*, rooted in separation of powers, that agencies can permissibly act only where they have the statutory power to do so.

B. Agencies Should Not Be Accorded Deference When They Exceed Their Statutory Authority

1. The question whether an agency has the authority to act is distinct from, and more serious than, the question whether agency action is "reasonable" for purposes of judicial review under the APA. As to the latter question, it has become a foundational tenet of administrative law that agencies must be accorded deference in the interpretation of statutes Congress has placed within their care, insofar as they comport with the plain meaning or discernible purpose of the legislation. *Mead*, 533 U.S. at 227-28; *Chevron*, 467 U.S. at 843-44. The *Mead* case champions the "interpretive choices" that agencies make, requiring that they be given a "fair measure of deference" where they exhibit "care ... formality, and relative expertness." 533 U.S. at 228.

This judicial deference presumes agency authority, and conversely raises extremely troubling constitutional issues where a court deems an agency's action to be without statutory basis. One legal scholar has postulated, in reacting to the Court's establishment of *Chevron* deference, that the notion that "administrators should decide the scope of their own authority" "flatly contradicts separation-of-powers principles that date back to *Marbury v. Madison*." Cass R. Sunstein, *Constitutionalism After the New Deal*, 101 HARV. L. REV. 421, 467 (1987).[3]

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[3] Professor Sunstein advocates a "firm judicial hand" in reviewing issues of agency overreaching due to the "potential for self-interested decisions" that "ultimately redound[] to the agency's benefit." 101 HARV. L. REV. at 468. He notes specifically the constitutional implications of deferring to unelected agency official that are subject to none of "the ordinary electoral safeguards or the usual checks and balances. *Id.*

The D.C. Circuit has itself expressed concerns that presumptions in favor of agency authority may do violence to the Constitution. In *Railway Labor Executives' Assn. v. National Mediation Board*, 29 F.3d 655 (D.C. Cir. 1994), the court of appeals rejected an agency's argument that Congress's failure to negate its authority in a particular area must be interpreted as an intent to grant that authority. It held that "[w]ere courts to presume a delegation of power absent an express withholding of such powers, agencies would enjoy virtually limitless hegemony, a result plainly out of keeping with *Chevron* and quite likely with the Constitution as well." 29 F.3d at 671. *See also Ethyl Corp. v. EPA*, 51 F.3d 1053, 1060 (D.C. Cir. 1995); *Oil, Chemical and Atomic Workers Int'l Union*, 46 F.3d 82, 90 (D.C. Cir. 1995). Yet in this case, the same court of appeals rewarded such "hegemony," not by finding statutory authority where none existed, but in looking the other way when the FCC clearly overstepped its authority.

2. Nor is petitioner's question resolved by the notion that agencies may assume authority to take action in furtherance of an ambiguous statute or one that does not comprehensively address a regulatory problem. *See Morton v. Ruiz*, 415 U.S. 199, 231 (1974). In *Morton*, the Court granted agencies permission for "the formulation of policy and the making of rules to fill any gap left, implicitly or explicitly, by Congress." *Id.* That authority is limited, however, to instances in which the agency is required to "administer a congressionally created and funded program" or similarly specific policy. *Id.* In such circumstances, agency "gap-filling" is "necessarily require[d]" to carry out a clear Congressional statutory initiative — for example, the administration of a fund designed to assist low-income native Americans. *Id.* Absent that Congressional initiative, agency action that ex-

ceeds its jurisdiction is simply an exercise in self-aggrandizing bureaucracy.

Thus, while this Court has held that an agency is owed deference on the substantive implementation of its statutes, it has not provided that same favored treatment where it is unclear whether the agency may act in the first instance. For while courts must presume the value of agency expertise and refrain from second-guessing their decisions, bedrock issues of Congressional delegation of power cannot be deemed within the agency's expertise to decide. *See New York Shipping Ass'n v. Fed. Maritime Comm'n*, 854 F.2d 1338, 1363 (D.C. Cir. 1988), *cert. denied*, 488 U.S. 1041 (1989) (holding that it is inappropriate to defer to an agency where it is interpreting its own jurisdiction). As Justice Brennan once wrote, "this Court has never deferred to an agency's interpretation of a statute designed to confine the scope of its jurisdiction." *Mississippi Power & Light v. Miss. ex rel. Moore*, 487 U.S. 354, 387 (1988) (Brennan, J., dissenting).

3. These cases stand in sharp contrast to those in which only the agency's reasoning, and not its jurisdiction, is questionable. *E.g.*, *Texas Ofc. of Pub. Util. Counsel v. FCC*, 265 F.3d 313 (5th Cir. 2001) (remanding FCC order on "universal service" and access charge reallocations); *Allied-Signal v. U.S. Nuclear Reg. Comm'n*, 988 F.2d 146 (D.C. Cir. 1993) (remanding regulatory fee allocation rules that the agency was authorized by statute to assess); *International Union, United Mine Workers of America v. Federal Mine Safety and Health Admin.*, 920 F.2d 960, 967 (D.C. Cir. 1990); *Maryland People's Counsel v. FERC*, 768 F.2d 450, 452 (D.C. Cir. 1985) (affirming FERC rules permitting natural gas producers to amend existing supply contracts). In these instances, application of *Chevron* deference remains appropriate, for it is altogether proper that agencies addressing issues committed to their expertise by Congress should enjoy lati-

tude in exercising that special competence. As such, this Court "ha[s] long recognized that considerable weight should be accorded to an executive department's construction of a statutory scheme it is entrusted to administer." *Chevron*, 467 U.S. at 844.

Not so when no such scheme has been delegated. *See Mead*, 121 S. Ct. 2172 n.6; *Adams Fruit*, 494 U.S. at 649. As in this case, where an agency acts beyond the scope of power delegated to it by Congress, the root policies supporting deference disappear. Yet that is in fact what the court of appeals has done in this case. By permitting the reciprocal compensation rules of the *ISP Remand Order* to stand, the court allows the agency the opportunity (for the third time) to parse the Communications Act in order to find a statutory "hook" for its substantive objectives. By failing to vacate the intercarrier compensation rules, the court of appeals allows the agency's view of its own authority, as a practical matter, to override the appellate court's holding. Thus, the D.C. Circuit's approach, if left uncorrected, injects highly problematic constitutional issues into administrative procedure and conflicts with the clear import of this Court's cases holding that administrative agencies are not entitled to deferential appellate review on questions of statutory jurisdiction.

C. The Court of Appeals' Reliance on a "Non-Trivial Likelihood" of Agency Authority Is Sharply Inconsistent With Administrative Law Procedure In Other Circuits and Presents Serious Issues of Unprincipled Judicial Decision Making

1. The D.C. Circuit has twice held on the merits that each of the FCC's attempts to rationalize reciprocal compensation with the Internet were groundless. *Bell Atlantic*, 206 F.3d at 6 (Pet App. 51a-53a); *WorldCom*, 288 F.3d at 433-34 (Pet. App. 8a-9a). In *Bell Atlantic*, the remedy was complete

vacatur. In *WorldCom*, by contrast, the court of appeals' insistence on statutory authorization melted, without explanation, into a hope that the FCC might articulate a defensible statutory basis for regulating reciprocal compensation for ISP-bound traffic. Accepting for the first time a "non-trivial likelihood" of authority in lieu of actual agency jurisdiction, the court of appeals established with no discussion a standard of administrative law that is inconsistent with prevailing jurisprudence and that presents a very serious risk of unprincipled judicial decision making.

2. This Court's reasoning in *Bowen* has become the linchpin of agency review, producing a fairly consistent treatment of agency jurisdictional defects by *vacatur* of extra-jurisdictional administrative actions. *E.g.*, *O'Keefe*, 132 F.3d at 1257 ("An agency's promulgation of rules without valid statutory authority implicates core notions of the separation of powers, and we are required by Congress to set these regulations aside."); *Butts v. City of New York Department of Housing Preservation & Development*, 990 F.2d 1397, 1409-11 (2d Cir. 1993); *Johnson v. Uncle Ben's, Inc.*, 965 F.2d 1363, 1373-74 (5th Cir. 1992) (rejecting retroactive application but noting "tension" between *Bowen* and cases permitting application of new laws enacted during pendency of litigation); *United States v. Murphy*, 937 F.2d 1032, 1037-38 (6th Cir. 1991) (rejecting retroactive application of amendments to criminal False Claims Act).

Indeed, until *WorldCom*, the D.C. Circuit followed this approach and routinely vacated agency rules found to exceed the scope of statutory authority. *Michigan v. EPA*, 268 F.3d 1075, 1081 (D.C. Cir. 2001) (vacating EPA program under the Clean Air Act on native American lands); *American Petroleum Inst. v. EPA*, 52 F.3d 1113, 1119 (D.C. Cir. 1995) (vacating EPA rule governing oxygenate fuel additives); *Motion Picture Ass'n of America v. Oman*, 969 F.2d 1154,

1157 (D.C. Cir. 1992) (reversing Copyright Office's imposition of interest on copyright royalties under *Bowen*'s prohibition on retroactive rulemaking in absence of express Congressional intent). In applying *Bowen*, the D.C. Circuit has flatly declared that "if there is no statute conferring authority, a federal agency has none." *Michigan*, 268 F.3d at 1081. The uniform result has been *vacatur* of the rules. *See id.* at 1089. *See also Transohio Sav. Bank v. Director, Office of Thrift Supervision*, 967 F.2d 598, 621 (D.C. Cir. 1992) ("Agency actions beyond delegated authority are '*ultra vires*,' and courts must invalidate them.") (abrogating unlawful contract executed by OTS).[4]

The court of appeals has been particularly stringent when reviewing other FCC actions, and has vacated numerous rules for which the agency had not supplied statutory support. *Fox Television Stations v. FCC*, 280 F.3d 1027, 1053 (D.C. Cir. 2002) (vacating cable/broadcast cross-ownership rules); *WorldCom, Inc. v. FCC*, 246 F.3d 690, 696 (D.C. Cir. 2001) (vacating FCC decision that Digital Subscriber Line service fell under its exclusive jurisdiction as "interstate access service"); *Illinois Pub. Telecomms. Ass'n v. FCC*, 117 F.3d 555 (D.C. Cir. 1998) (vacating portions of FCC's payphone compensation rules; subsequent history omitted); *COMSAT Corp. v. FCC*, 114 F.3d 223, 225 (D.C. Cir. 1998) (vacating FCC amendment imposing special fees

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[4] Numerous other decisions by the court of appeals have vacated unauthorized agency rules even prior to this Court's instruction in *Bowen*. *Middle South Energy v. FERC*, 747 F.2d 763 (D.C. Cir. 1984); *National Petroleum Refiners Ass'n v. FTC*, 482 F.2d 672 (D.C. Cir. 1973). Like *Bowen*, these cases begin from the proposition that a federal agency "is a creation of Congress," such that "its powers can be decided only by considering the powers Congress specifically granted it." *National Petroleum Refiners*, 482 F.2d at 674.

on satellite licensees); *Bell Atlantic Tel. Cos. v. FCC*, 24 F.3d 1141 (D.C. Cir. 1994) (vacating FCC collocation rules as a constitutional taking lacking statutory authority).

3. In remanding the *ISP Remand Order* despite reversing the agency's assertion of statutory authority over the subject matter, the court of appeals' decision in *WorldCom* omits all reference to *Bowen*, its progeny, and that court's own consistent practice. It creates for the first time a new standard of review of agency jurisdiction, the "non-trivial likelihood" test, 288 F.3d at 434 (Pet. App. 9a), but does not draw this test from any established decision or doctrine. Instead, the court of appeals purports to base this new law on its conclusion in an earlier case that "'[t]he decision whether to vacate depends on 'the seriousness of the order's deficiencies (and thus the extent of doubt whether the agency chose correctly) and the disruptive consequences of an interim change that my itself be changed.'" 288 F.3d at 434 (quoting *Allied-Signal*, 988 F.2d at 150-51 (Pet App. 8a-9a)).

Yet the court of appeals' reliance on *Allied-Signal* to justify remand is spurious. That case did not involve a challenge to an agency's statutory authority. To the contrary, it was simply a review of Nuclear Regulatory Commission action with respect to regulatory cost recovery that the court of appeals found "cannot be viewed as reasoned decision-making." 988 F.2d at 148, 150. The agency's error was clearly curable, requiring that the court of appeals simply remand it for further consideration. In short, the "seriousness of the order's deficiencies" was insubstantial. Importantly, the *Allied-Signal* test appears never to have been applied to avoid *vacatur* of agency rules reversed for lack of statutory jurisdiction. Therefore, for the court of appeals to imply that

Allied-Signal permits remand of, rather than vacating, the FCC's order in this case is not sensible.[5]

4. The court of appeals' "non-trivial likelihood" test is also inconsistent with what appears to be settled practice in other circuits. As noted above, the Eighth Circuit has adhered closely to the theory of *Bowen* and been unsympathetic to agencies that regulate in excess of their jurisdiction. *E.g.*, *O'Keefe*, 132 F.3d at 1254. Even in cases in which the only question is whether an agency's rationale and explanation are reasonable, other courts have adopted an approach that routinely compels reversal on a finding of extra-jurisdictional agency action.

For example, in *Idaho Farm Bureau Federation v. Babbitt*, 58 F.3d 1392 (9th Cir. 1995), the Ninth Circuit let stand the United States Fish and Wildlife Service's addition of the Spring Snail onto the endangered species list, despite serious defects in the agency's rulemaking proceedings (the agency relied on key evidence supporting the addition after the close of the period for comment). Chastising the agency for its "significant procedural error," the Court observed that "[o]rdinarily when a regulation is not promulgated in compliance with the APA, the regulation is invalid." 58 F.3d at 1405. Nonetheless, the Ninth Circuit remanded the endan-

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[5] Although not germane to the issue posed in this petition, the court of appeals implied that the FCC's new reciprocal compensation regulations exhibited no "disruptive consequences." 288 F.3d at 434 (quoting 988 F.2d at 150-51) (Pet App. 9a). To the contrary, however, appellants had demonstrated the substantial financial loss that the new rules would cause, likely resulting in their exit from the market. *See* 288 F.3d at 432 (Pet. App. 4a). The court of appeals' cavalier acceptance of the opposite conclusion without record support is inconsistent with the APA's "arbitrary and capricious" standard for judicial review. *See* 5 U.S.C. § 706(2)(A) (Pet. App. 13a).

gered species list, without vacating it, due to the real danger that the Spring Snail might become extinct if the rule were voided. 58 F.3d at 1405-06.

The contrast between *Idaho Farm Federation* and *WorldCom* cannot be more clear. Although each evinces the concept of equitable flexibility in deciding an appellate remedy, the Ninth Circuit's approach assumes that vacating regulations based on invalid procedures or deficient reasoning is the ordinary rule, subject to exception in extraordinary circumstances. Under the *WorldCom* approach, however, the presumption is reversed, and only in the unusual situation in which there is not even a "trivial" chance the agency can correct its decision will unlawfully promulgated rules be vacated. Thus, the court of appeals has created a system in which the most serious administrative errors — which as discussed above strike at the heart of our traditional notions of separation of powers — are subject to the most lenient appellate remedies. This has things backwards. If there is a presumption in favor of remand rather than *vacatur,* it should apply where the agency clearly has jurisdiction but provided a flawed rationale or process to substantiate its actions, not where agency action is legally *ultra vires.*

Idaho Farm Federation also illustrates why the Court's attention to this case is so needed. In applying this "equitable concern," the Ninth Circuit cited and followed a 1991 decision of the D.C. Circuit providing that weighing of equities may in some circumstances warrant leniency to the agency. *Id.* at 1406 (citing *Fertilizer Inst. v. EPA*, 935 F.2d 1303, 1312 (D.C. Cir. 1991)). It is precisely this type of reliance on the D.C. Circuit that requires reversal of *WorldCom.* The vast majority of significant administrative law cases originate in the D.C. Circuit, and that court's decisions have for decades set the tone for federal administrative law nationwide. Thus, the impact of *WorldCom* is far greater

than the specific reciprocal compensation rules at issue, because the D.C. Circuit's "non-trivial likelihood" test may be adopted by other courts. Despite its lack of reasoning and precedent, the court of appeals' decision below may start an appellate slide toward the amorphous "non-trivial likelihood" standard in lieu of the *vacatur* requirement that *Mead*, *Bowen* and the language of the APA all clearly imply. *See Mead*, 533 U.S. at 228 n.6 (suggesting that agency actions beyond their jurisdiction merit no judicial deference and should be reversed summarily).

5. Even without reference to other circuits, *WorldCom* evidences an unexplained collapse of the D.C. Circuit into what appears to be *ad hoc*, results-oriented appellate review of agency action. Two other communications decisions in 2002 have applied a similarly careless approach to the question of whether *vacatur* of agency rules is required, with (predictably) inconsistent results.

In *Sinclair Broadcast Group v. FCC*, 284 F.3d 148 (D.C. Cir. 2002), the court of appeals found that FCC rules limiting the number of local television stations owned by one entity lacked a rational connection with Congressional intent for regulation that "is 'necessary in the public interest.'" 284 F.2d at 165. It nonetheless permitted the ownership rules to stand. Circuit Judge Sentelle issued a strong dissent on this point, stating that the panel's finding required that it vacate the challenged rules as being without statutory authority. Judge Sentelle criticized the agency for having simply "assumed the need for the rule, and then attempted to justify it," 284 F.3d at 171, which under prior D.C. Circuit practice would have resulted in *vacatur*. *Id.* (quoting *Radio-Television News Dirs. Ass'n v. FCC*, 184 F.3d 872, 876 (D.C. Cir. 1999)). *Sinclair* thus appears to suffer from the same ill-conceived jurisdictional deference established in *WorldCom*, demonstrating the dangerous trend now at work.

At the other end of the spectrum is *United States Telecom Ass'n v. FCC*, 290 F.3d 415, 429 (D.C. Cir. 2002), in which the court of appeals vacated a different FCC decision solely on the ground that the agency's reasoning was incomplete. The *USTA* opinion, issued after *WorldCom*, addressed whether the FCC had ordered monopoly telephone companies to "share" customer lines with Digital Subscriber Line providers without adequately considering whether alternative customer lines were available. *USTA*, 290 F.3d at 428. The court of appeals decried this "naked disregard of the competitive context" of local telecommunications, vacating the order completely, without citing to or harmonizing the *WorldCom* opinion. Thus, the outcome appears to be the result of the panel's visceral reaction to the FCC's implementation of the procompetitive provisions of the 1996 Act, a difference on policy that, even if appropriate for an appellate court, should hardly dictate the APA remedy.

6. Courts of appeals should no more base decisions about whether to remand or vacate agency action on their policy predilections than they may indulge in policymaking. Courts are subject to well-settled appellate constraints that prohibit judges from displacing or second-guessing agency expertise. *Securities and Exchange Comm'n v. Chenery Corp.*, 318 U.S. 80, 88 (1943). *See also Chevron*, 47 U.S. at 843. These strictures are not cosmetic, but are wedded to fundamental principles of Congressional delegation and separation of powers. *See Railway Executives*, 29 F.3d at 671; *O'Keefe*, 132 F.3d at 1257. *See also* Sunstein, 101 Harv. L. Rev. at 467.

The evil of the court of appeals' approach is thus that it delegates unfettered discretion to individual appellate panels to decide whether to remand or to vacate unlawful agency rules without any judicially manageable standards. This trend of *ad hoc* decisions on this important practical question

is sure to continue in the D.C. Circuit, as recent cases clearly suggest, and may extend to other circuits as well. Unprincipled court of appeals' decisions on the appellate remedy for unlawful agency action is the natural result of *WorldCom*, one this Court should grant *certiorari* to review and correct.

II. THE COURT OF APPEALS' ERROR IN *WORLDCOM* WILL HAVE FAR-REACHING ADVERSE EFFECTS ON AGENCY POWER THAT CANNOT BE CONTROLLED BY THE COURTS

The *WorldCom* judgment permits the FCC to continue enforcing its new ISP reciprocal compensation rules, with the caveat that on remand it must identify a valid statutory basis consistent with the panel's opinion. Yet as a result of this approach, it is likely that there will never be a determination as to whether the agency has jurisdiction over ISP-bound traffic. As a realistic matter, *the FCC need never act on remand because the substance of its rules can remain in effect, in perpetuity, without any further decision by the agency and prior to any appellate review on the merits.*

1. This precedent does nothing less than reward and encourage renegade agency action. If permitted to stand, the *WorldCom* opinion will allow all federal agencies to exceed and self-determine their authority, effectively negating the ability of Congress and the federal courts to prescribe the bounds of their regulatory power.

The legal effect of the panel's approach is to permit the continued enforcement of rules that have never been, and may never be, subject to substantive judicial review. The WorldCom case marks the second instance in which the court of appeals declined the opportunity to assess the rea-

sonableness of intercarrier compensation for ISP-bound calls. It will be years before any court has an opportunity to determine whether the ISP reciprocal compensation rules are based on valid statutory authority. Having remanded the case to the Commission "simply ... for further proceedings," 288 F.3d at 434, the court of appeals provided the FCC with no compulsion under which the agency must justify its exercise of authority.

The court of appeals' decision returns this core issue of agency jurisdiction to the dozens of open local competition dockets that await FCC resolution. Unfortunately, this Court has no assurance that the matter will return from those depths. The FCC's long delay in consideration of D.C. Circuit remands is legendary. (For instance, it took the agency nearly two years to decide this case after remand in *Bell Atlantic*.) And here the FCC has no incentive to issue *any* decision on remand because its substantive objective — including the preemption of state regulation of ISP-bound traffic — has already been achieved. Its intercarrier compensation rules will stay in effect unless and until the FCC makes a remand decision ripe for judicial review; the agency thus has a powerful incentive to do absolutely nothing.

More importantly, perhaps, the only means by which the court of appeals could reassert appellate authority over ISP reciprocal compensation would be through a writ of mandamus compelling FCC action "unreasonably delayed." *See* 5 U.S.C. § 706(1) (Pet. App. 13a). These extraordinary writs are seldom granted, however. *Telecommunications Research & Action Center v. FCC*, 750 F.2d 70, 79 (D.C. Cir. 1984). This judicial restraint is borne out of a sense of comity with the Executive Branch, reserving review of unreasonable delay of action only for "extraordinary circumstances." *In re International Chemical Workers Union*, 958 F.2d 1144, 1149 (D.C. Cir. 1992). *See Cutler v. Hayes*, 818 F.2d 879 (D.C.

Cir. 1987); *Public Citizen Health Research Group v. Auchter*, 702 F.2d 1150 (D.C. Cir. 1983). Moreover, the court of appeals' historical treatment of agency delay has entailed an intensely fact-specific inquiry, providing no bright-line test for determining appropriate judicial intervention. *Compare Cutler*, 818 F.2d at 897 (the Court must examine the length of time action has been pending), with *Auchter*, 702 F.2d at 1157-58 (the Court must evaluate the reasonableness of the delay in the context of the agency's statutory mandates, but "[d]elays that might be altogether reasonable in the sphere of economic regulation are less tolerable when human lives are at stake."). It is manifestly unclear under this precedent whether, if the FCC's reconsideration of the *ISP Remand Order* is years delayed, the court of appeals will later have cause to compel it to act.

Even having failed to advance any defensible theory to authorize the *ISP Remand Order*, the FCC won in the court of appeals. Despite having no jurisdiction to regulate ISP reciprocal compensation, the FCC is indeed regulating it. Its scheme for restricting the recovery of intercarrier compensation by new competitive entrants remains in force and, though it is likely to have an irreversible negative impact on the competitive industry, remains immune from substantive judicial review. No court has ever passed on the substantive soundness of the rules, under *Chevron* or any other standard. Thus, until the FCC makes another formal attempt to reveal its authority for intercarrier compensation rules – an effort for which there is no court-ordered requirement – the rules will remain immune from judicial scrutiny. This cannot be the appropriate appellate response to an agency that has twice been held to have exceeded its jurisdiction in seeking to regulate reciprocal compensation for ISP-bound traffic.

2. The consequences of *WorldCom* are thus extremely dangerous. Federal administrative agencies can lawlessly

promulgate rules that exceed their authority, confident that under the "non-trivial likelihood" standard, appellate review will, at worst, only result in remand.[6] The decision therefore threatens to create a new administrative despotism in America, in which bureaucracies act unconstrained by statutory limits and have an unlimited number of chances to identify some basis for their rules. All the while, and completely without regard to their substantive content, agency rules will remain in effect — despite jurisdictional invalidity — until the agencies themselves affirmatively decide to act. This is a recipe for disaster and a classic example of the judiciary abdicating its APA and constitutional responsibility to control wayward bureaucracies through application of Congress's jurisdictional limitations.

As a matter of administrative law doctrine, accepting review in this case will enable the Court to complete *Bowen* and *Mead* by finally clarifying that agency action taken without authority must be vacated, without deference to the agency's interpretation or policies. Because this Court's prior decisions have only implied this conclusion, stopping short of expressly deciding the issue, the court of appeals was able to create a new *vacatur* standard in *WorldCom* and fashion relief, apparently based on its own views of commu-

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[6] Indeed, in appeals subsequent to *WorldCom*, the FCC has not hesitated to argue that under the "non-trivial likelihood" standard, remand is the only appropriate appellate remedy. In the *USTA* case described herein, the FCC stated in its Response to WorldCom, Inc's Motion for Partial Stay of Mandate repeated back to the court of appeals the WorldCom standard, stating that the standards for *vacatur* "require the Court to consider whether there is a 'non-trivial likelihood' that the agency lawfully could reinstate the rule on remand, and whether vacatur followed by reinstatement on remand could result in 'disruptive consequences.'" FCC Response at 1-2, Case Nos. 00-1012 *et al.* (Aug. 16, 2002).

nications policy, completely indifferent to the validity or legal merits of the challenged regulations. This approach, unfortunately repeated by the D.C. Circuit in a number of recent cases, threatens to dismantle decades of appellate practice in favor of unprincipled judicial policymaking. With the increasing politicization of both agencies and the courts, this trend – if left unchecked – will reward officials and judges who utilize social engineering, rather than statutory mandates, to regulate in their own image.

CONCLUSION

For all these reasons, the writ of certiorari should be granted.

Respectfully submitted,

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APPENDIX

No. 02-____

IN THE

Supreme Court of the United States

CORE COMMUNICATIONS, INC.

Petitioner,

v.

FEDERAL COMMUNICATIONS COMMISSION AND THE UNITED STATES OF AMERICA,

Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

PETITIONER'S APPENDIX

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WorldCom, Inc., Petitioner v. Federal Communications Commission and United States of America, Respondents; Sprint Corporation, *et al.*, Intervenors

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United States Court of Appeals
For the District of Columbia Circuit

288 F.3d 429; 2002 U.S. App. LEXIS 8542

February 12, 2002, Argued
May 3, 2002, Decided

WILLIAMS, *Senior Circuit Judge*: Section 251(b)(5) of the Telecommunications Act of 1996, 47 U.S.C. §§ 151 (the "1996 Act" or the "Act"), directs all local exchange carriers ("LECs") to "establish reciprocal compensation arrangements for the transport and termination of telecommunications." 47 U.S.C. § 251 (b)(5). In the order before us the Federal Communications Commission held that under § 251(g) of the Act it was authorized to "carve out" from § 251(b)(5) calls made to internet service providers ("ISPs") located within the caller's local calling area. It relied entirely on § 251(g). Because that section is worded simply as a transitional device, preserving various LEC duties that antedated the 1996 Act until such time as the Commission should adopt new rules pursuant to the Act, we find the Commission's reliance on § 251(g) precluded. Thus we remand the case. Because there may well be other legal bases for adopting the rules chosen by the Commission for compensation between the originating and the terminating LECs in calls to ISPs, we neither vacate the

order nor address petitioners' attacks on various interim provisions devised by the Commission.

Due in part to the 1996 Act, local telephone service areas are now typically (perhaps universally) served by more than one LEC. The reciprocal compensation requirement of § 251(b)(5), quoted above, is aimed at assuring compensation for the LEC that completes a call originating within the same area. Although its literal language purports to extend reciprocal compensation to *all* "telecommunications," the Commission has construed it as limited to "local" traffic only. *In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, 11 FCC Rcd. 15499, 16012-13, ¶¶ 1033-34, 16015-16, ¶ 1040 (1996) ("Local Competition Order"); 47 C.F.R. § 51.701(a). For long distance calls, by contrast, the long-distance carrier collects from the user and pays both LECs — the one originating and the one terminating the call. Local Competition Order, 11 FCC Rcd. at 16013, ¶ 1034.

In an earlier order, the Commission excluded ISP calls from the reach of § 251(b)(5) on the theory that they were indeed not "local." *In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, Inter-Carrier Compensation for ISP-Bound Traffic*, 14 FCC Rcd. 3689 (1999) ("Initial Order"). It reached this conclusion by applying its "end-to-end" analysis, traditionally employed in determining whether a call was jurisdictionally interstate or not, stressing that ISP-bound traffic ultimately reaches websites that are typically located out-of state. *See id.* at 3689-90, ¶ 1, 3695-98, ¶¶ 10-12, 3703, ¶ 23 (1999). On review, we held that the order had failed to adequately explain why the traditional "end-to-end" jurisdictional analysis was relevant to deciding whether ISP calls fitted the local call or the long-distance call model, and

vacated and remanded the order. *Bell Atlantic Tel. Cos. v. FCC*, 340 U.S. App. D.C. 328, 206 F.3d 1, 5, 8 (D.C. Cir. 2000)

On remand, the FCC again reached the conclusion that the compensation between two LECs involved in delivering internet-bound traffic to an ISP should not be governed by the reciprocal compensation provision of § 251(b)(5). *In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, Intercarrier Compensation for ISP-Bound Traffic*, 16 FCC Rcd. 9151, 9152-53, ¶ 1 (2001) ("*Remand Order*"). This decision rested, as we said, on § 251(g). Having thus taken ISP calls out of § 251(b)(5)'s reciprocal compensation obligation, the FCC proceeded to establish what it believed was an appropriate cost recovery mechanism. *Remand Order*, 16 FCC Rcd. at 9154, ¶ 4. The system adopted was "bill-and-keep," whereby each carrier recovers its costs from its own end-users. *Id.*

In reaching the bill-and-keep solution, the Commission pointed to a number of flaws in the prevailing intercarrier compensation mechanism for ISP calls, under which the originating LEC paid the LEC that served the ISP. Because ISPs typically generate large volumes of one-way traffic in their direction, the old system attracted LECs that entered the business simply to serve ISPs, making enough money from reciprocal compensation to pay their ISP customers for the privilege of completing the calls. The Commission saw this as leading, at least potentially, to ISPs' charging *their* customers below cost. *Remand Order*, 16 FCC Rcd. at 9153, ¶ 2, 9154-55, ¶¶ 4-6, 9162, ¶¶ 19-21.

To smooth the transition to bill-and-keep (but without fully committing itself to it), the FCC adopted several interim cost-recovery rules that sought to limit arbitrage

opportunities by lowering the amounts and capping the growth of ISP-related intercarrier payments. These tend to force ISP-serving LECs to recover an increasing portion of their costs from their own subscribers rather than from other LEC's. *Remand Order*, 16 FCC Rcd. at 9155-57, ¶ 7-8. The transitional rules take effect on the expiration of existing interconnection agreements. *Id.* at 9189, ¶ 82. Finally, the Commission specified that, having carved ISP-bound calls out of § 251(b)(5) under § 251(g), it was establishing the interim compensation regime under its general authority to regulate the rates and terms of interstate telecommunications services and interconnections between carriers under § 201 of the Act; as a result, the state regulatory commissions would no longer have jurisdiction over ISP-bound traffic as part of their power to resolve LEC interconnection issues under § 252(e)(1) of the Act. *Id.*

Two sets of petitioners now challenge the Remand Order. One, headed by .WorldCom (collectively "WorldCom"), consists of competitive LECs that deliver calls to ISPs, and thus stand to lose reciprocal compensation payments. These companies contend that the Commission erred in finding that § 251(g) authorized Commission exclusion of such calls from § 251(b)(5), and that, in any event, the interim compensation rules that the FCC adopted were not a product of reasoned decision making and are contrary to the Act's terms. The other group, composed of several states and state regulatory commissions, complains that the order unlawfully preempts their authority to determine the compensation of ISP-serving LECs.

Section 251(g) reads as follows:

(g) Continued enforcement of exchange access and interconnection requirements.

On and after [the date of enactment of the

> Telecommunications Act of 1996,] each local exchange carrier, to the extent that it provides wireline services, shall provide exchange access, *information access*, and exchange services for such access *to interexchange carriers and information service providers in accordance with the same equal access and nondiscriminatory interconnection restrictions and obligations (including receipt of compensation) that apply to such carrier on the date immediately preceding [the date of enactment of the Telecommunications Act of 1996]* under any court order, consent decree, or regulation, order, or policy of the Commission, until such restrictions and obligations are explicitly superseded by regulations prescribed by the Commission after [such date of enactment]. During the period beginning on [such date of enactment] and until such restrictions and obligations are so superseded, such restrictions and obligations shall be enforceable in the same manner as regulations of the Commission.

47 U.S.C. § 251 (g) (emphasis added). Both sides assume that *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 81 L. Ed. 2d 694, 104 S. Ct. 2778 (1984), is applicable, so that we must defer to any reasonable Commission interpretation not precluded by the language of the statute, read with the ordinary tools of statutory construction. We agree with petitioners that § 251(g) is not susceptible to the Commission's reading.

On its face, § 251(g) appears to provide simply for the "continued enforcement" of certain pre-Act regulatory "interconnection restrictions and obligations," including the ones contained in the consent decree that broke up the Bell System, until they are explicitly superceded by Commission

action implementing the Act. As the Conference Report explained, "because the [Act] completely eliminates the prospective effect of the AT&T Consent Decree, some provision is necessary to keep these requirements in place.... Accordingly, the conference agreement includes a new section 251(g)." H.R. Rep. 104-458, at 122-23 (1996).

On a prior occasion, the Commission also framed the scope of § 251(g) in similarly narrow terms:

> The term "information access" first appears [in the Act] in sections [sic] 251(g). That provision is a *transitional enforcement mechanism* that obligates the incumbent LECs to continue to abide by equal access and nondiscriminatory interconnection requirements of the [AT&T Consent Decree] when such carriers "provide exchange access, information access and exchange services for such access to interexchange carriers and information service providers...." Because the provision incorporates into the Act, on a transitional basis, these [AT&T Consent Decree] requirements, the Act uses [AT&T Consent Decree] terminology in this section. *However, this provision is merely a continuation of the equal access and nondiscrimination provisions of the Consent Decree until superseded by subsequent regulations of the Commission.*

In the Matter of Deployment of Wireline Services Offering Advanced Telecommunications Capability, 15 FCC Rcd 385, 407, ¶ 47 (1999) (footnote omitted) (emphasis added).

Of course such explanatory language can't be assumed to be exclusive; legislative or agency explanations of a provision may naturally tend to focus on its most salient features. Thus, despite legislative history speaking only in

terms of the Consent Decree, plainly the preexisting "restrictions and obligations" covered by § 251(g) are *not* limited to Consent Decree obligations; the statute itself explicitly embraces pre-existing obligations under a "regulation, order, or policy of the Commission." *See also Noland v. Shalala*, 304 U.S. App. D.C. 232, 12 F.3d 258, 262 (D.C. Cir. 1994) ("Although the legislative history ... suggests an exclusive focus [of the statutory provision in question], the statutory language is broader and may permit [an alternative] construction."). But nothing in § 251(g) seems to invite the Commission's reading, under which (it seems) it could override virtually any provision of the 1996 Act so long as the rule it adopted were in some way, however remote, linked to LECs' pre-Act obligations.

We will assume without deciding that under § 251(g) the Commission might *modify* LECs' pre-Act "restrictions" or "obligations," pending full implementation of relevant sections of the Act. The Fifth Circuit appeared to make that assumption in *Texas Office of Public Utility Counsel v. FCC*, 265 F.3d 313 (5th Cir. 2001), where it implicitly relied on § 251(g) (by quoting language from an Eighth Circuit case, *Texas Office of Public Utility Counsel v. FCC*, 265 F.3d 313 (5th Cir. 2001), in sustaining modifications of pre-Act regulations governing the access charges paid to LECs by inter-exchange carriers ("IXCs"). 265 F.3d at 324-25. But this assumption is not enough to justify the Commission's action here, as it seems uncontested — and the Commission declared in the Initial Order — that there had been *no* pre-Act obligation relating to intercarrier compensation for ISP-bound traffic. *See* 265 F.3d at 324-25. *see also id.* at 3690, P 1, 3707-3710, ¶¶ 28-36. The best the Commission can do on this score is to point to pre-existing LEC obligations to provide interstate access for ISPs. *See, e.g.*, Remand Order, 16 FCC Rcd at 9164, ¶ 27; *In the Matter of MTS & WATS Market Structure*, 97 F.C.C.2d 682,

711-15, ¶¶ 77-83 (1983). Indeed, the Commission does not even point to any pre-Act, federally created obligation for LECs to interconnect to each other for ISP-bound calls. And even if this hurdle were overcome, there would remain the fact that § 251(g) speaks only of services provided "to interexchange carriers and information service providers"; LECs' services to other LECs, even if en route to an ISP, are not "to" either an IXC or to an ISP.

Having found that § 251(g) does not provide a basis for the Commission's action, we make no further determinations. For example, as in *Bell Atlantic*, we do not decide whether handling calls to ISPs constitutes "telephone exchange service" or "exchange access" (as those terms are defined in the Act, 47 U.S.C. §§ 153 (16), 153(47)) or neither, or whether those terms cover the universe to which such calls might belong. Nor do we decide the scope of the "telecommunications" covered by § 251(b)(5). Nor do we decide whether the Commission may adopt bill-and-keep for ISP-bound calls pursuant to § 251(b)(5); *see* § 252(d)(B)(i) (referring to bill-and-keep). Indeed these are only samples of the issues we do not decide, which are in fact all issues other than whether § 251(g) provided the authority claimed by the Commission for not applying § 251(b)(5).

Moreover, we do not decide petitioners' claims that the interim pricing limits imposed by the Commission are inadequately reasoned. Because we can't yet know the legal basis for the Commission's ultimate rules, or even what those rules may prove to be, we have no meaningful context in which to assess these explicitly transitional measures.

Finally, we do not vacate the order. Many of the petitioners themselves favor bill-and-keep, and there is plainly a non-trivial likelihood that the Commission has authority to elect such a system (perhaps under §§ 251(b)(5)

and 252(d)(B)(i)). *See, e.g., Allied-Signal, Inc. v. U.S. Nuclear Regulatory Comm.*, 300 U.S. App. D.C. 198, 988 F.2d 146, 150-51 (D.C. Cir. 1993) ("The decision whether to vacate depends on 'the seriousness of the order's deficiencies (and thus the extent of doubt whether the agency chose correctly) and the disruptive consequences of an interim change that may itself be changed.'"). Thus, we simply remand the case to the Commission for further proceedings.

So ordered.

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

WorldCom Inc.,
Petitioner,

v.

Federal Communications
Commission and United
States of America,
Respondents.

Sprint Corporation, et al.,
Intervenors

Consolidated with 01-1229, 01-1243,
01-1255, 01-1256, 01-1257, 01-1274,
01-1310, 01-1311, 01-1313, 01-1321

BEFORE: Ginsburg, Chief Judge, Edwards,
Sentelle, Henderson*, Randolph, Rogers, Tatel,
and Garland*, Circuit Judges, and Williams,
Senior Circuit Judge

ORDER

Upon consideration of petitioner Core Communications, Inc.'s petition for rehearing en banc, and in the absence of a request by any member of the court for a vote, it is

ORDERED that the petition be denied.

Per Curiam

FOR THE COURT:
Mark J. Langer, Clerk

By: Michael C. McGrail
Deputy Clerk

* Circuit Judge Henderson and Circuit Judge Garland did not participate in this matter.

Telecommunications Act of 1996
Section 251(b)(5)
47 U.S.C. § 251(b)(6)

OBLIGATIONS OF ALL LOCAL EXCHANGE CARRIERS.— Each local exchange carrier has the following duties:

(5) RECIPROCAL COMPENSATION. — The duty to establish reciprocal compensation arrangements for the transport and termination of telecommunications.

Administrative Procedure Act
Section 706
5 U.S.C. § 706

SCOPE OF REVIEW — To the extent necessary to decision and when presented, the reviewing court shall decide all relevant questions of law, interpret constitutional and statutory provisions, and determine the meaning or applicability of the terms of an agency action. The reviewing court shall —

(1) compel agency action unlawfully withheld or unreasonably delayed;

(2) hold unlawful and set aside agency action, findings, and conclusions found to be —

(A) arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law;

(B) contrary to constitutional right, power, privilege, or immunity;

(C) in excess of statutory jurisdiction, authority, or limitations, or short of statutory right;

(D) without observance of procedure required by law;

(E) unsupported by substantial evidence in a case subject to section 556 and 557 of this title or otherwise reviewing on the record of an agency hearing provided by statute; or

(F) unwarranted by the facts to the extend that the facts are subject to trial de novo by the reviewing court.

In making the foregoing determinations, the court shall review the whole record or those parts of it cited by a party, and due account shall be taken of the rule of prejudicial error.

Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of
Implementation of the Local Competition
Provisions in the Telecommunications Act
Of 1996

Intercarrier Compensation for
ISP-Bound Traffic

CC Docket Nos. 96-98, 99-68

ORDER ON REMAND AND REPORT AND ORDER

Adopted: April 18, 2001
Released: April 27, 2001

By the Commission: Chairman Powell issuing a statement; Commissioner Furchtgott-Roth dissenting and issuing a statement.

INTRODUCTION

1. In this Order, we reconsider the proper treatment for purposes of intercarrier compensation of telecommunications traffic delivered to Internet service providers (ISPs). We previously found in the *Declaratory Ruling*[1] that such traffic is interstate traffic subject to the

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[1] *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996; Intercarrier Compensation for ISP-Bound Traffic*, Declaratory Ruling in CC Docket No. 96-98 and Notice of Proposed Rulemaking in CC Docket No. 99-68, 14 FCC Rcd. 3689 (1999) (*Declaratory Ruling* or *Intercarrier Compensation NPRM*).

jurisdiction of the Commission under section 201 of the Act[2] and is not, therefore, subject to the reciprocal compensation provisions of section 251(b)(5).[3] The Court of Appeals for the District of Columbia Circuit held on appeal, however, that the *Declaratory Ruling* failed adequately to explain why our jurisdictional conclusion was relevant to the applicability of section 251(b)(5) and remanded the issue for further consideration.[4] As explained in more detail below, we modify the analysis that led to our determination that ISP-bound traffic falls outside the scope of section 251(b)(5) and conclude that Congress excluded from the "telecommunications" traffic subject to reciprocal compensation the traffic identified in section 251(g), including traffic destined for ISPs. Having found, although for different reasons than before, that the provisions of section 251(b)(5) do not extend to ISP-bound traffic, we reaffirm our previous conclusion that traffic delivered to an ISP is predominantly interstate access traffic subject to section 201 of the Act, and we establish an appropriate cost recovery mechanism for the exchange of such traffic.

2. We recognize that the existing intercarrier compensation mechanism for the delivery of this traffic, in which the originating carrier pays the carrier that serves the ISP, has created opportunities for regulatory arbitrage and distorted the economic incentives related to competitive entry into the local exchange and exchange access markets.

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[2] *See* 47 U.S.C. § 201, Communications Act of 1934 (the Act), as amended by the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996 Act). Hereinafter, all citations to the Act and to the 1996 Act will be to the relevant section of the United States Code unless otherwise noted.

[3] 47 U.S.C. § 251(b)(5).

[4] *See Bell Atl. Tel. Cos. v. FCC*, 206 F.3d 1 (D.C. Cir. 2000) (*Bell Atlantic*).

As we discuss in the *Unified Intercarrier Compensation NPRM*,[5] released in tandem with this Order, such market distortions relate not only to ISP-bound traffic, but may result from any intercarrier compensation regime that allows a service provider to recover some of its costs from other carriers rather than from its end-users. Thus, the *NPRM* initiates a proceeding to consider, among other things, whether the Commission should replace existing intercarrier compensation schemes with some form of what has come to be known as "bill and keep."[6] The *NPRM* also considers modifications to existing payment regimes, in which the calling party's network pays the terminating network, that might limit the potential for market distortion. The

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[5] Developing a Unified Intercarrier Compensation Regime, CC Docket No. 01-92, Notice of Proposed Rulemaking, FCC 01-132 (rel. April 27, 2001) ("*Unified Intercarrier Compensation NPRM*" or "*NPRM*").

[6] "Bill and keep" refers to an arrangement in which neither of two interconnecting networks charges the other for terminating traffic that originates on the other network. Instead, each network recovers from its own end-users the cost of both originating traffic that it delivers to the other network and terminating traffic that it receives from the other network. Implementation of the Local Competition Provisions in the Telecommunications Act of 1996; Interconnection between Local Exchange Carriers and Commercial Mobile Radio Service Providers, CC Docket Nos. 96-98, 95-185, First Report and Order, 11 FCC Rcd 15499, 16045 (1996) (*Local Competition Order*), *aff'd in part and vacated in part sub nom. Competitive Telecommunications Ass'n v. FCC*, 117 F.3d 1068 (8th Cir. 1997) (*CompTel*), *aff'd in part and vacated in part sub nom. Iowa Utils. Bd. v. FCC*, 120 F.3d 753 (8th Cir. 1997) (*Iowa Utils. Bd.*), *aff'd in part and rev'd in part sub nom., AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. 366 (1999); Order on Reconsideration, 11 FCC Rcd 13042 (1996); Second Order on Reconsideration, 11 FCC Rcd 19738 (1996); Third Order on Reconsideration and Further Notice of Proposed Rulemaking, 12 FCC Rcd 12460 (1997); *further recon. pending*. Bill and keep does not, however, preclude intercarrier charges for transport of traffic between carriers' networks. *Id.*

regulatory arbitrage opportunities associated with intercarrier payments are particularly apparent with respect to ISP-bound traffic, however, because ISPs typically generate large volumes of traffic that is virtually all one-way -- that is, delivered to the ISP. Indeed, there is convincing evidence in the record that at least some carriers have targeted ISPs as customers merely to take advantage of these intercarrier payments. Accordingly, in this Order we also take interim steps to limit the regulatory arbitrage opportunity presented by ISP-bound traffic while we consider the broader issues of intercarrier compensation in the *NPRM* proceeding.

EXECUTIVE SUMMARY

3. As presaged above, we must wrestle with two difficult issues in this Order: first, whether intercarrier compensation for ISP-bound traffic is governed by section 251 or section 201; and, if the latter, what sort of compensation mechanism should apply. The first question is difficult because we do not believe it is resolved by the plain language of section 251(b)(5) but, instead, requires us to consider the relationship of that section to other provisions of the statute. Moreover, we recognize the legitimate questions raised by the court with respect to the rationales underlying our regulatory treatment of ISPs and ISP traffic. We seek to respond to those questions in this Order. Ultimately, however, we conclude that Congress, through section 251(g),[7] expressly limited the reach of section 251(b)(5) to exclude ISP-bound traffic. Accordingly, we affirm our conclusion in the *Declaratory Ruling* that ISP-bound traffic is not subject to the reciprocal compensation obligations of section 251(b)(5).

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[7] 47 U.S.C. § 251(g).

4. Because we determine that intercarrier compensation for ISP-bound traffic is within the jurisdiction of this Commission under section 201 of the Act, it is incumbent upon us to establish an appropriate cost recovery mechanism for delivery of this traffic. Based upon the record before us, it appears that the most efficient recovery mechanism for ISP-bound traffic may be bill and keep, whereby each carrier recovers costs from its own end-users. As we recognize in the *NPRM*, intercarrier compensation regimes that require carrier-to-carrier payments are likely to distort the development of competitive markets by divorcing cost recovery from the ultimate consumer of services. In a monopoly environment, permitting carriers to recover some of their costs from interconnecting carriers might serve certain public policy goals. In order to promote universal service, for example, this Commission historically has capped end-user common line charges and required local exchange carriers to recover any shortfall through per-minute charges assessed on interexchange carriers.[8] These sorts of implicit subsidies cannot be sustained, however, in the competitive markets for telecommunications services envisioned by the 1996 Act. In the *NPRM*, we suggest that, given the opportunity, carriers always will prefer to recover their costs from other carriers rather than their own end-users in order to gain competitive advantage. Thus carriers have every incentive to compete, not on basis of quality and efficiency, but on the basis of their ability to shift costs to other carriers, a troubling distortion that prevents market forces from distributing limited investment resources to their most efficient uses.

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[8] Access Charge Reform, CC Docket No. 96-262, First Report and Order, 12 FCC Rcd 15982, 15998-99 (1997) (*Access Charge Reform Order*), *aff'd, Southwestern Bell Telephone Co. v. FCC*, 153 F.3d 523 (8th Cir. 1998).

5. We believe that this situation is particularly acute in the case of carriers delivering traffic to ISPs because these customers generate extremely high traffic volumes that are entirely one-directional. Indeed, the weight of the evidence in the current record indicates that precisely the types of market distortions identified above are taking place with respect to this traffic. For example, comments in the record indicate that competitive local exchange carriers (CLECs), on average, terminate eighteen times more traffic than they originate, resulting in annual CLEC reciprocal compensation billings of approximately two billion dollars, ninety percent of which is for ISP-bound traffic.[9] Moreover, the traffic imbalances for some competitive carriers are in fact much greater, with several carriers terminating more than forty times more traffic than they originate.[10] There is nothing inherently wrong with carriers having substantial traffic imbalances arising from a business decision to target specific types of customers. In this case, however, we

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[9] *See, e.g.*, Letter from Robert T. Blau, BellSouth, to Magalie Roman Salas, Secretary, FCC (November 6, 2000); *see also* Verizon Remand Comments at 2 (Verizon will be billed more than one billion dollars in 2000 for Internet-bound calls); Letter from Richard J. Metzger, Focal, to Deena Shetler, Legal Advisor to Commissioner Gloria Tristani, FCC (Jan. 11, 2001)(ILECs owed $1.98 billion in reciprocal compensation to CLECs in 2000). On June 23, 2000, the Commission released a Public Notice seeking comment on the issues raised by the court's remand. *See* Comment Sought on Remand of the Commission's Reciprocal Compensation Declaratory Ruling by the U.S. Court of Appeals for the D.C. Circuit, CC Docket Nos. 96-98, 99-68, Public Notice, 15 FCC Rcd 11311 (2000) (*Public Notice*). Comments and reply comments filed in response to the *Public Notice* are identified herein as "Remand Comments" and "Remand Reply Comments," respectively. Comments and replies filed in response the 1999 *Intercarrier Compensation NPRM* are identified as "Comments" and "Reply Comments," respectively.

[10] *See, e.g.*, Verizon Remand Comments at 11, 21.

believe that such decisions are driven by regulatory opportunities that disconnect costs from end-user market decisions. Thus, under the current carrier-to-carrier recovery mechanism, it is conceivable that a carrier could serve an ISP free of charge and recover all of its costs from originating carriers. This result distorts competition by subsidizing one type of service at the expense of others.

6. Although we believe this arbitrage opportunity is particularly manifest with respect to ISP-bound traffic, we suggest in the *NPRM* that any compensation regime based on carrier-to-carrier payments may create similar market distortions. Accordingly, we initiate an inquiry as to whether bill and keep is a more economically efficient compensation scheme than the existing carrier-to-carrier payment mechanisms. Alternatively, the record developed in that proceeding may suggest modifications to carrier-to-carrier cost recovery mechanisms that address the competitive concerns identified above. Based upon the current record, however, bill and keep appears the preferable cost recovery mechanism for ISP-bound traffic because it eliminates a substantial opportunity for regulatory arbitrage. We do not fully adopt a bill and keep regime in this Order, however, because there are specific questions regarding bill and keep that require further inquiry, and we believe that a more complete record on these issues is desirable before requiring carriers to recover most of their costs from end-users. Because these questions are equally relevant to our evaluation of a bill and keep approach for other types of traffic, we will consider them in the context of the *NPRM*. Moreover, we believe that there are significant advantages to a global evaluation of the intercarrier compensation mechanisms applicable to different types of traffic to ensure a more systematic, symmetrical treatment of these issues.

7. Because the record indicates a need for immediate action with respect to ISP-bound traffic, however, in this Order we will implement an interim recovery scheme that: (i) moves aggressively to eliminate arbitrage opportunities presented by the existing recovery mechanism for ISP-bound by lowering payments and capping growth; and (ii) initiates a 36-month transition towards a complete bill and keep recovery mechanism while retaining the ability to adopt an alternative mechanism based upon a more extensive evaluation in the *NPRM* proceeding. Specifically, we adopt a gradually declining cap on the amount that carriers may recover from other carriers for delivering ISP-bound traffic. We also cap the amount of traffic for which any such compensation is owed, in order to eliminate incentives to pursue new arbitrage opportunities. In sum, our goal in this Order is decreased reliance by carriers upon carrier-to-carrier payments and an increased reliance upon recovery of costs from end-users, consistent with the tentative conclusion in the *NPRM* that bill and keep is the appropriate intercarrier compensation mechanism for ISP-bound traffic. In this regard, we emphasize that the rate caps we impose are not intended to reflect the costs incurred by each carrier that delivers ISP traffic. Some carriers' costs may be higher; some are probably lower. Rather, we conclude, based upon all of the evidence in this record, that these rates are appropriate limits on the amounts recovered from other carriers and provide a reasonable transition from rates that have (at least until recently) typically been much higher. Carriers whose costs exceed these rates are (and will continue to be) able to collect additional amounts from their ISP customers. As we note above, and explain in more detail below, we believe that such end-user recovery likely is the most efficient mechanism.

8. The basic structure of this transition is as follows:

- Beginning on the effective date of this Order, and continuing for six months, intercarrier compensation for ISP-bound traffic will be capped at a rate of $.0015/minute-of-use (mou). Starting in the seventh month, and continuing for eighteen months, the rate will be capped at $.0010/mou. Starting in the twenty-fifth month, and continuing through the thirty-sixth month or until further Commission action (whichever is later), the rate will be capped at $.0007/mou. Any additional costs incurred must be recovered from end-users. These rates reflect the downward trend in intercarrier compensation rates contained in recently negotiated interconnection agreements, suggesting that they are sufficient to provide a reasonable transition from dependence on intercarrier payments while ensuring cost recovery.

- We also impose a cap on total ISP-bound minutes for which a local exchange carrier (LEC) may receive this compensation. For the year 2001, a LEC may receive compensation, pursuant to a particular interconnection agreement, for ISP-bound minutes up to a ceiling equal to, on an annualized basis, the number of ISP-bound minutes for which that LEC was entitled to compensation under that agreement during the first quarter of 2001, plus a ten percent growth factor. For 2002, a LEC may receive compensation for ISP-bound minutes up to a ceiling equal to the minutes for which it was entitled to compensation in 2001, plus another ten percent growth factor. In 2003, a LEC may receive compensation for ISP-bound minutes up to a ceiling equal to the 2002 ceiling. These caps are consistent with projections of the growth of dial-up Internet access for the first two years of the transition and are necessary to ensure that such growth does not

undermine our goal of limiting intercarrier compensation and beginning a transition toward bill and keep. Growth above these caps should be based on a carrier's ability to provide efficient service, not on any incentive to collect intercarrier payments.

- Because the transitional rates are *caps* on intercarrier compensation, they have no effect to the extent that states have ordered LECs to exchange ISP-bound traffic either at rates below the caps or on a bill and keep basis (or otherwise have not required payment of compensation for this traffic). The rate caps are designed to provide a transition toward bill and keep, and no transition is necessary for carriers already exchanging traffic at rates below the caps.

- In order to limit disputes and costly measures to identify ISP-bound traffic, we adopt a rebuttable presumption that traffic exchanged between LECs that exceeds a 3:1 ratio of terminating to originating traffic is ISP-bound traffic subject to the compensation mechanism set forth in this Order. This ratio is consistent with those adopted by state commissions to identify ISP or other convergent traffic that is subject to lower intercarrier compensation rates. Carriers that seek to rebut this presumption, by showing that traffic above the ratio is not ISP-bound traffic or, conversely, that traffic below the ratio is ISP-bound traffic, may seek appropriate relief from their state commissions pursuant to section 252 of the Act.

- Finally, the rate caps for ISP-bound traffic (or such lower rates as have been imposed by states commissions for the exchange of ISP-bound traffic) apply only if an incumbent LEC offers to exchange

all traffic subject to section 251(b)(5) at the same rate. An incumbent LEC that does not offer to exchange section 251(b)(5) traffic at these rates must exchange ISP-bound traffic at the state-approved or state-negotiated reciprocal compensation rates reflected in their contracts. The record fails to demonstrate that there are inherent differences between the costs of delivering a voice call to a local end-user and a data call to an ISP, thus the "mirroring" rule we adopt here requires that incumbent LECs pay the same rates for ISP-bound traffic that they receive for section 251(b)(5) traffic.

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3. ISP-Bound Traffic Falls within the Categories Enumerated in Section 251(g)

42. Having determined that section 251(g) serves as a limitation on the scope of "telecommunications" embraced by section 251(b)(5), the next step in our inquiry is to determine whether ISP-bound traffic falls within one or more of the categories specified in section 251(g): exchange access, information access, and exchange services for such access provided to IXCs and information service providers. Regardless of whether this traffic falls under the category of "exchange access" — an issue pending before the D.C. Circuit in a separate proceeding[11] — we conclude that this

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[11] *See Worldcom, Inc. v. FCC*, No. 00-1022 et al. (D.C. Cir.). In that proceeding, the Commission has argued that the category previously labeled "information access" under the MFJ is a subset of those services now falling under the category "exchange access" as set forth in section 3(16) of the Act, 47 U.S.C. 153(16), while incumbent LECs and others have argued that the two categories are mutually

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traffic, at a minimum, falls under the rubric of "information access," a legacy term imported into the 1996 Act from the MFJ, but not expressly defined in the Communications Act.

a. Background

43. Section 251(g) by its terms indicates that, in the provision of exchange access, information access, and exchange services for such access to IXCs and information service providers, various pre-existing requirements and obligations "including receipt of compensation" are preserved, whether these obligations stem from "any court order, *consent decree*, or regulation, order or policy of the Commission." (Emphasis added.) Similarly, in discussing this provision, the Joint Explanatory Statement of the Committee of Conference explicitly refers to preserving the obligations under the "AT&T Consent Decree."[12]

b. Discussion

44. We conclude that Congress's reference to "information access" in section 251(g) was intended to incorporate the meaning of the phrase "information access" as used in the AT&T Consent Decree.[13] The ISP-bound traffic at issue here falls within that category because it is

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exclusive. We need not reargue here whether "information access" is a subset of "exchange access" or whether instead they are mutually exclusive categories. The only issue relevant to our section 251(g) inquiry in this case is whether ISP-bound traffic falls, at a minimum, within the legacy category of "information access." Both the Commission and incumbent LECs have agreed that the access provided to ISPs satisfies the definition of information access.

[12] *Joint Explanatory Statement of the Committee of Conference*, S. Conf. Rep. No. 230, 104th Cong., 2d Session at 123 (February 1, 1996).

[13] *United States v. AT&T*, 552 F. Supp. at 196, 229.

traffic destined for an information service provider.[14] Under the consent decree, "information access" was purchased by "information service providers" and was defined as "the provision of specialized exchange telecommunications services . . . in connection with the origination, termination, transmission, switching, forwarding or routing of telecommunications traffic to or from the facilities of a provider of information services."[15] We conclude that this definition of "information access" was meant to include all access traffic that was routed by a LEC "to or from" providers of information services, of which ISPs are a subset.[16] The record in this proceeding also supports our interpretation.[17] When Congress passed the 1996 Act, it

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[14] *See* Letter from Gary L. Phillips, SBC, to Jon Nuechterlein, Deputy General Counsel, FCC, at 9 (Dec. 14, 2000)(stating that section 251(g) applies by its very terms to "information access").

[15] *United States v. AT&T*, 552 F. Supp. at 196, 229.

[16] This finding is consistent with our past statements on the issue. In the *Non-Accounting Safeguards Order*, we found that the access that LECs provide to enhanced service providers, including ISPs, constitutes "information access" as the MFJ defines that term. Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act, CC Docket No. 96-149, First Report and Order and Further Notice of Proposed Rulemaking, 11 FCC Rcd 21905, 22024 & n.621 (1996). Although we subsequently overruled our statement in that order that ISPs do not also purchase "exchange access" under section 3(16), we have not altered our finding that the access provided to enhanced service providers (including ISPs) is "information access." *Advanced Services Remand Order*, 15 FCC Rcd at 404-05.

[17] *See, e.g.*, Letter from Gary L. Phillips, SBC, to Jon Nuechterlein, Deputy General Counsel, FCC, at 9 (Dec. 14, 2000). Some have argued that "information access" includes only certain specialized functions unique to the needs of enhanced service providers and does not include basic telecommunications links used to provide enhanced service providers with access to the LEC network. *See, e.g.*, Brief of WorldCom, Inc., D.C. Circuit No. 00-1002, *et al.*, filed Oct. 3, 2000, at 16 n.12. The MFJ definition of information access, however,

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adopted new terminology. The term "information access" is not, therefore, part of the new statutory framework. Because the legacy term "information access" in section 251(g) encompasses ISP-bound traffic, however, this traffic is excepted from the scope of the "telecommunications" subject to reciprocal compensation under section 251(b)(5).

* * * * * *

2. Intercarrier Compensation for ISP-bound Traffic

77. We believe that a hybrid mechanism that establishes relatively low per minute rates, with a cap on the total volume of traffic entitled to such compensation, is the most appropriate interim approach over the near term to resolve the problems associated with the current intercarrier compensation regime for ISP-bound traffic. Our primary goal at this time is to address the market distortions under

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includes the telecommunications links used for the "origination, termination, [and] transmission" of information services, *and* "*where necessary*, the provision of network signalling" and other functions. *United States v. AT&T*, 552 F. Supp. at 229 (emphasis added). Others have argued that the "information access" definition engrafts a geographic limitation that renders this service category a subset of telephone exchange service. *See* Letter from Richard Rindler, Swindler, Berlin, to Magalie Roman Salas, Secretary, FCC, at 3 (Apr. 12, 2001). We reject that strained interpretation. Although it is true that "information access" is necessarily initiated "in an exchange area," the MFJ definition states that the service is provided "*in connection with* the origination, termination, transmission, switching, forwarding or routing of telecommunications traffic to or from the facilities of a provider of information services" *United States v. AT&T*, 552 F. Supp. at 229 (emphasis added). Significantly, the definition does not further require that the transmission, once handed over to the information service provider, terminate within the same exchange area in which the information service provider first received the access traffic.

the current intercarrier compensation regimes for ISP-bound traffic. At the same time, we believe it prudent to avoid a "flash cut" to a new compensation regime that would upset the legitimate business expectations of carriers and their customers. Subsequent to the Commission's Declaratory Ruling, many states have required the payment of reciprocal compensation for ISP-bound traffic, and CLECs may have entered into contracts with vendors or with their ISP customers that reflect the expectation that the CLECs would continue to receive reciprocal compensation revenue. We believe it appropriate, in tailoring an interim compensation mechanism, to take those expectations into account while simultaneously establishing rates that will produce more accurate price signals and substantially reduce current market distortions. Therefore, pending our consideration of broader intercarrier compensation issues in the NPRM, we impose an interim intercarrier compensation regime for ISP-bound traffic that serves to limit, if not end, the opportunity for regulatory arbitrage, while avoiding a market-disruptive "flash cut" to a pure bill and keep regime. The interim regime we establish here will govern intercarrier compensation for ISP-bound traffic until we have resolved the issues raised in the intercarrier compensation NPRM.

78. Beginning on the effective date of this Order, and continuing for six months, intercarrier compensation for ISP-bound traffic will be capped at a rate of $.0015/minute-of-use (mou). Starting in the seventh month, and continuing for eighteen months, the rate will be capped at $.0010/mou. Starting in the twenty-fifth month, and continuing through the thirty-sixth month or until further Commission action (whichever is later), the rate will be capped at $.0007/mou. In addition to the rate caps, we will impose a cap on total ISP-bound minutes for which a LEC may receive this compensation. For the year 2001, a LEC may receive compensation, pursuant to a particular interconnection

agreement, for ISP-bound minutes up to a ceiling equal to, on an annualized basis, the number of ISP-bound minutes for which that LEC was entitled to compensation under that agreement during the first quarter of 2001, plus a ten percent growth factor. For 2002, a LEC may receive compensation, pursuant to a particular interconnection agreement, for ISP-bound minutes up to a ceiling equal to the minutes for which it was entitled to compensation under that agreement in 2001, plus another ten percent growth factor. In 2003, a LEC may receive compensation, pursuant to a particular interconnection agreement, for ISP-bound minutes up to a ceiling equal to the 2002 ceiling applicable to that agreement.

79. We understand that some carriers are unable to identify ISP-bound traffic. In order to limit disputes and avoid costly efforts to identify this traffic, we adopt a rebuttable presumption that traffic delivered to a carrier, pursuant to a particular contract, that exceeds a 3:1 ratio of terminating to originating traffic is ISP-bound traffic that is subject to the compensation mechanism set forth in this Order. Using a rebuttable presumption in this context is consistent with the approach that numerous states have adopted to identify ISP-bound traffic or "convergent" traffic (including ISP traffic) that is subject to a lower reciprocal compensation rate. A carrier may rebut the presumption, for example, by demonstrating to the appropriate state commission that traffic above the 3:1 ratio is in fact local traffic delivered to non-ISP customers. In that case, the state commission will order payment of the state-approved or state-arbitrated reciprocal compensation rates for that traffic. Conversely, if a carrier can demonstrate to the state commission that traffic it delivers to another carrier is ISP-bound traffic, even though it does not exceed the 3:1 ratio, the state commission will relieve the originating carrier of reciprocal compensation payments for that traffic, which is

subject instead to the compensation regime set forth in this Order. During the pendency of any such proceedings, LECs remain obligated to pay the presumptive rates (reciprocal compensation rates for traffic below a 3:1 ratio, the rates set forth in this Order for traffic above the ratio), subject to true-up upon the conclusion of state commission proceedings.

80. We acknowledge that carriers incur costs in delivering traffic to ISPs, and it may be that in some instances those costs exceed the rate caps we adopt here. To the extent a LEC's costs of transporting and terminating this traffic exceed the applicable rate caps, however, it may recover those amounts from its own end-users. We also clarify that, because the rates set forth above are caps on intercarrier compensation, they have no effect to the extent that states have ordered LECs to exchange ISP-bound traffic either at rates below the caps we adopt here or on a bill and keep basis (or otherwise have not required payment of compensation for this traffic). The rate caps are designed to provide a transition toward bill and keep or such other cost recovery mechanism that the Commission may adopt to minimize uneconomic incentives, and no such transition is necessary for carriers already exchanging traffic at rates below the caps. Moreover, those state commissions have concluded that, at least in their states, LECs receive adequate compensation from their own end-users for the transport and termination of ISP-bound traffic and need not rely on intercarrier compensation.

81. Finally, a different rule applies in the case where carriers are not exchanging traffic pursuant to interconnection agreements prior to adoption of this Order (where, for example, a new carrier enters the market or an existing carrier expands into a market it previously had not served). In such a case, as of the effective date of this

Order, carriers shall exchange ISP-bound traffic on a bill-and-keep basis during this interim period. We adopt this rule for several reasons. First, our goal here is to address and curtail a pressing problem that has created opportunities for regulatory arbitrage and distorted the operation of competitive markets. In so doing, we seek to confine these market problems to the maximum extent while seeking an appropriate long-term resolution in the proceeding initiated by the companion NPRM. Allowing carriers in the interim to expand into new markets using the very intercarrier compensation mechanisms that have led to the existing problems would exacerbate the market problems we seek to ameliorate. For this reason, we believe that a standstill on any expansion of the old compensation regime into new markets is the more appropriate interim answer. Second, unlike those carriers that are presently serving ISP customers under existing interconnection agreements, carriers entering new markets to serve ISPs have not acted in reliance on reciprocal compensation revenues and thus have no need of a transition during which to make adjustments to their prior business plans.

82. The interim compensation regime we establish here applies as carriers re-negotiate expired or expiring interconnection agreements. It does not alter existing contractual obligations, except to the extent that parties are entitled to invoke contractual change-of-law provisions. This Order does not preempt any state commission decision regarding compensation for ISP-bound traffic for the period prior to the effective date of the interim regime we adopt here. Because we now exercise our authority under section 201 to determine the appropriate intercarrier compensation for ISP-bound traffic, however, state commissions will no longer have authority to address this issue. For this same reason, as of the date this Order is published in the Federal Register, carriers may no longer

invoke section 252(i) to opt into an existing interconnection agreement with regard to the rates paid for the exchange of ISP-bound traffic. Section 252(i) applies only to agreements arbitrated or approved by state commissions pursuant to section 252; it has no application in the context of an intercarrier compensation regime set by this Commission pursuant to section 201.

83. This interim regime satisfies the twin goals of compensating LECs for the costs of delivering ISP-bound traffic while limiting regulatory arbitrage. The interim compensation regime, as a whole, begins a transition toward what we have tentatively concluded, in the companion NPRM, to be a more rational cost recovery mechanism under which LECs recover more of their costs from their own customers. This compensation mechanism is fully consistent with the manner in which the Commission has directed incumbent LECs to recover the costs of serving ESPs, including ISPs. The three-year transition we adopt here ensures that carriers have sufficient time to re-order their business plans and customer relationships, should they so choose, in light of our tentative conclusions in the companion NPRM that bill and keep is the appropriate long-term intercarrier compensation regime. It also affords the Commission adequate time to consider comprehensive reform of all intercarrier compensation regimes in the NPRM and any resulting rulemaking proceedings. Both the rate caps and the volume limitations reflect our view that LECs should begin to formulate business plans that reflect decreased reliance on revenues from intercarrier compensation, given the trend toward substantially lower rates and the strong possibility that the NPRM may result in the adoption of a full bill and keep regime for ISP-bound traffic.

84. We acknowledge that there is no exact

science to setting rate caps to limit carriers' ability to draw revenue from other carriers, rather than from their own end-users. Our adoption of the caps here is based on a number of considerations. First, rates that produce meaningful reductions in intercarrier payments for ISP-bound traffic must be at least as low as rates in existing interconnection agreements. Second, although we make no finding here regarding the actual costs incurred in the delivery of ISP-bound traffic, there is evidence in the record to suggest that technological developments are reducing the costs incurred by carriers in handling all sorts of traffic, including ISP-bound traffic. Third, although the process has proceeded too slowly to address the market distortions discussed above, we note that negotiated reciprocal compensation rates continue to decline as ILECs and CLECs negotiate new interconnection agreements. Finally, CLECs have been on notice since the 1999 Declaratory Ruling that it might be unwise to rely on the continued receipt of reciprocal compensation for ISP-bound traffic, thus many have begun the process of weaning themselves from these revenues.

85. The rate caps adopted herein reflect all these considerations. The caps we have selected approximate the downward trend in intercarrier compensation rates reflected in recently negotiated interconnection agreements. In these agreements, carriers have agreed to rates, like those we adopt here, that decline each year of a three-year contract term, and at least one agreement reflects different rates for balanced and unbalanced traffic. For example, the initial rate cap of $.0015/mou approximates the rates applicable this year in agreements Level 3 has negotiated with Verizon and SBC. The $.0010/mou rate that applies during most of the three-year interim period reflects a proposal by ALTS, the trade association representing CLECs, for a transition plan pursuant to which intercarrier compensation payments for ISP-bound traffic would decline to $.0010/mou.

Similarly, the $.0007/mou rate reflects the average rate applicable in 2002 under Level 3's agreement with SBC. We conclude, therefore, that the rate caps constitute a reasonable transition toward the recovery of costs from end-users.

86. We impose an overall cap on ISP-bound minutes for which compensation is due in order to ensure that growth in dial-up Internet access does not undermine our efforts to limit intercarrier compensation for this traffic and to begin, subject to the conclusion of the NPRM proceedings, a smooth transition toward a bill and keep regime. A ten percent growth cap, for the first two years, seems reasonable in light of CLEC projections that the growth of dial-up Internet minutes will fall in the range of seven to ten percent per year. We are unpersuaded by the ILECs' projections that dial-up minutes will grow in the range of forty percent per year, but adoption of a cap on growth largely moots this debate. If CLECs have projected growth in the range of ten percent, then limiting intercarrier compensation at that level should not disrupt their customer relationships or their business planning. Nothing in this Order prevents any carrier from serving or indeed expanding service to ISPs, so long as they recover the costs of additional minutes from their ISP customers. The caps merely ensure that growth in minutes above the caps is based on a given carrier's ability to provide efficient and quality service to ISPs, rather than on a carrier's desire to reap an intercarrier compensation windfall.

87. We are not persuaded by arguments proffered by CLECs that requiring them to recover more of their costs from their ISP customers will render it impossible for CLECs profitably to serve ISPs or will lead to higher rates for Internet access. First, as noted above, this compensation mechanism is fully consistent with the manner in which this

Commission has directed ILECs to recover the costs of serving ISPs. Moreover, the evidence in the record does not demonstrate that CLECs cannot compete for ISP customers in the growing number of states that have adopted bill and keep for ISP-bound traffic or that the cost of Internet access has increased in those states. Second, next-generation switching and other technological developments appear to be contributing to a decline in the costs of serving ISPs (and other customers). Third, if reciprocal compensation merely enabled CLECs to recover the costs of serving ISPs, CLECs should be indifferent between serving ISPs and other customers. Instead, CLECs have not contradicted ILEC assertions that more than ninety percent of CLEC reciprocal compensation billings are for ISP-bound traffic, suggesting that there may be a considerable margin between current reciprocal compensation rates and the actual costs of transport and termination. Finally, there is reason to believe that our failure to act, rather than the actions we take here, would lead to higher rates for Internet access, as ILECs seek to recover their reciprocal compensation liability, which they incur on a minute-of-use basis, from their customers who call ISPs. Alternatively, ILECs might recover these costs from all of their local customers, including those who do not call ISPs. There is no public policy rationale to support a subsidy running from all users of basic telephone service to those end-users who employ dial-up Internet access.

88. We also are not convinced by the claim of CLECs that limiting intercarrier compensation for ISP-bound traffic will result in a windfall for the incumbent LECs. The CLECs argue that the incumbents' local rates are set to recover the costs of originating and terminating calls and that the ILECs avoid termination costs when their end-users call ISP customers served by CLECs. The record does not establish that ILECs necessarily avoid costs when

they deliver calls to CLECs, and CLECs have not demonstrated that ILEC end-user rates are designed to recover from the originating end-user the costs of delivering calls to ISPs. The ILECs point out that, in response to their complaints about the costs associated with delivering traffic to ISPs, the Commission has directed them to seek permission from state regulators to raise the rates they charge the ISPs, an implicit acknowledgement that ILECs may not recover all of their costs from the originating end-user.

* * * * * *

VI. ORDERING CLAUSES

112. Accordingly, IT IS ORDERED, pursuant to Sections 1, 4(i) and (j), 201-209, 251, 252, 332, and 403 of the Communications Act, as amended, 47 U.S.C. §§ 151, 154(i), 154(j), 201-209, 251, 252, 332, and 403, and Section 553 of Title 5, United States Code, 5 U.S.C. § 553, that this Order on Remand and Report and Order and revisions to Part 51 of the Commission's rules, 47 C.F.R. Part 51, ARE ADOPTED. This Order on Remand and Report and Order and the rule revisions adopted herein will be effective 30 days after publication in the Federal Register except that, for good cause shown, as set forth in paragraph 82 of this Order, the provision of this Order prohibiting carriers from invoking section 252(i) of the Act to opt into an existing interconnection agreement as it applies to rates paid for the exchange of ISP-bound traffic will be effective immediately upon publication of this Order in the Federal Register.

113. IT IS FURTHER ORDERED that the Commission's Consumer Information Bureau, Reference Information Center, SHALL SEND a copy of this Order on Remand and Report and Order, including the Final Regulatory Flexibility Analysis, to the Chief Counsel for

Advocacy of the Small Business Administration.

FEDERAL COMMUNICATIONS COMMISSION

Magalie Roman Salas
Secretary

Bell Atlantic Telephone Companies, Petitioner v. Federal Communications Commission and United States of America, Respondents; Telecommunications Resellers Association, *et al.*, Intervenors

No. 99-1094, Consolidated with 99-1095, 99-1097, 99-1106, 99-1126, 99-1134, 99-1136, 99-1145

United States Court of Appeals for the District of Columbia Circuit

340 U.S. App. D.C. 328; 206 F.3d 1; 2000 U.S. App. LEXIS 4685; 19 Comm. Reg. (P & F) 1269

November 22, 1999, Argued
March 24, 2000, Decided

WILLIAMS, Circuit Judge: The Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56, 47 U.S.C. §§ 151-714, requires local exchange carriers ("LECs") to "establish reciprocal compensation arrangements for the transport and termination of telecommunications." Id. § 251(b)(5). When LECs collaborate to complete a call, this provision ensures compensation both for the originating LEC, which receives payment from the end-user, and for the recipient's LEC. By regulation the Commission has limited the scope of the reciprocal compensation requirement to "local telecommunications traffic." 47 CFR § 51.701(a). In the ruling under review, it considered whether calls to internet service providers ("ISPs") within the caller's local calling area are themselves "local." In doing so it applied its so-called "end-to-end" analysis, noting that the communication characteristically will ultimately (if indirectly) extend beyond the ISP to websites out-of-state and around the world. Accordingly it found the calls non-local. *See In the Matter of Implementation of the Local*

Competition Provisions in the Telecommunications Act of 1996, Intercarrier Compensation for ISP-Bound Traffic, 14 FCC Rcd 3689, 3690 (¶ 1) (1999) ("*FCC Ruling*").

Having thus taken the calls to ISPs out of § 251(b)(5)'s provision for "reciprocal compensation" (as it interpreted it), the Commission could nonetheless itself have set rates for such calls, but it elected not to. In a Notice of Proposed Rulemaking, CC Docket 99-68, the Commission tentatively concluded that "a negotiation process, driven by market forces, is more likely to lead to efficient outcomes than are rates set by regulation," *FCC Ruling*, 14 FCC Rcd at 3707 (¶ 29), but for the nonce it left open the matter of implementing a system of federal controls. It observed that in the meantime parties may voluntarily include reciprocal compensation provisions in their interconnection agreements, and that state commissions, which have authority to arbitrate disputes over such agreements, can construe the agreements as requiring such compensation; indeed, even when the agreements of interconnecting LECs include no linguistic hook for such a requirement, the commissions can find that reciprocal compensation is appropriate. *FCC Ruling*, 14 FCC Rcd at 3703-05 (¶¶ 24-25); see § 251(b)(1) (establishing such authority). "Any such arbitration," it added, "must be consistent with governing federal law." *FCC Ruling*, 14 FCC Rcd at 3705 (¶ 25).

This outcome left at least two unhappy groups. One, led by Bell Atlantic, consists of incumbent LECs (the "incumbents"). Quite content with the Commission's finding of § 251(b)(5)'s inapplicability, the incumbents objected to its conclusion that in the absence of federal regulation state commissions have the authority to impose reciprocal compensation. Although the Commission's new rulemaking on the subject may eventuate in a rule that preempts the states' authority, the incumbents object to

being left at the mercy of state commissions until that (hypothetical) time, arguing that the commissions have mandated exorbitant compensation. In particular, the incumbents, who are paid a flat monthly fee, have generally been forced to provide compensation for internet calls on a per-minute basis. Given the average length of such calls the cost can be substantial, and since ISPs do not make outgoing calls, this compensation is hardly "reciprocal."

Another group, led by MCI WorldCom, consists of firms that are seeking to compete with the incumbent LECs and which provide local exchange telecommunications services to ISPs (the "competitors"). These firms, which stand to receive reciprocal compensation on ISP-bound calls, petitioned for review with the complaint that the Commission erred in finding that the calls weren't covered by § 251(b)(5).

The end-to-end analysis applied by the Commission here is one that it has traditionally used to determine whether a call is within its interstate jurisdiction. Here it used the analysis for quite a different purpose, without explaining why such an extension made sense in terms of the statute or the Commission's own regulations. Because of this gap, we vacate the ruling and remand the case for want of reasoned decisionmaking.

* * *

In February 1996 Congress passed the Telecommunications Act of 1996 (the "1996 Act" or the "Act"), stating an intent to open local telephone markets to competition. See H.R. Conf. Rep. No. 104-458, at 113 (1996). Whereas before local exchange carriers generally had state-licensed monopolies in each local service area, the 1996 Act set out to ensure that "states may no longer enforce laws that impede[ ] competition," and subjected incumbent

LECs "to a host of duties intended to facilitate market entry." *AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. 366, 119 S. Ct. 721, 726, 142 L. Ed. 2d 834 (1999).

Among the duties of incumbent LECs is to "provide, for the facilities and equipment of any requesting telecommunications carrier, interconnection with the local exchange carrier's network ... for the transmission and routing of telephone exchange service and exchange access." 47 U.S.C. § 251(c)(2). ("Telephone exchange service" and "exchange access" are words of art to which we shall later return.) Competitor LECs have sprung into being as a result, and their customers call, and receive calls from, customers of the incumbents.

We have already noted that § 251(b)(5) of the Act establishes the duty among local exchange carriers "to establish reciprocal compensation arrangements for the transport and termination of telecommunications." 47 U.S.C. § 251(b)(5). Thus, when a customer of LEC A calls a customer of LEC B, LEC A must pay LEC B for completing the call, a cost usually paid on a per-minute basis. Although § 251(b)(5) purports to extend reciprocal compensation to all "telecommunications," the Commission has construed the reciprocal compensation requirement as limited to local traffic. *See* 47 CFR § 51.701(a) ("The provisions of this subpart apply to reciprocal compensation for transport and termination of local telecommunications traffic between LECs and other telecommunications carriers."). LECs that originate or terminate long-distance calls continue to be compensated with "access charges," as they were before the 1996 Act. Unlike reciprocal compensation, these access charges are not paid by the originating LEC. Instead, the long-distance carrier itself pays both the LEC that originates the call and links the caller to the long distance network, and the LEC that

terminates the call. *See In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, 11 FCC Rcd 15499, 16013 (¶ 1034) (1996) ("*Local Competition Order*").

The present case took the Commission beyond these traditional telephone service boundaries. The internet is "an international network of interconnected computers that enables millions of people to communicate with one another in 'cyberspace' and to access vast amounts of information from around the world." *Reno v. ACLU*, 521 U.S. 844, 844, 138 L. Ed. 2d 874, 117 S. Ct. 2329 (1997). Unlike the conventional "circuit-switched network," which uses a single end-to-end path for each transmission, the internet is a "distributed packet-switched network, which means that information is split up into small chunks or 'packets' that are individually routed through the most efficient path to their destination." *In the Matter of Federal-State Joint Board on Universal Service*, 13 FCC Rcd 11501, 11532 (¶ 64) (1998) ("*Universal Service Report*"). ISPs are entities that allow their customers access to the internet. Such a customer, an "end user" of the telephone system, will use a computer and modem to place a call to the ISP server in his local calling area. He will usually pay a flat monthly fee to the ISP (above the flat fee already paid to his LEC for use of the local exchange network). The ISP "typically purchases business lines from a LEC, for which it pays a flat monthly fee that allows unlimited incoming calls." *FCC Ruling*, 14 FCC Rcd at 3691 (¶ 4).

In the ruling now under review, the Commission concluded that § 251(b)(5) does not impose reciprocal compensation requirements on incumbent LECs for ISP-bound traffic. *FCC Ruling*, 14 FCC Rcd at 3690 (¶ 1). Faced with the question whether such traffic is "local" for

purposes of its regulation limiting § 251(b)(5) reciprocal compensation to local traffic, the Commission used the " end-to-end" analysis that it has traditionally used for jurisdictional purposes to determine whether particular traffic is interstate. Under this method, it has focused on "the end points of the communication and consistently has rejected attempts to divide communications at any intermediate points of switching or exchanges between carriers." *FCC Ruling*, 14 FCC Rcd at 3695 (¶ 10). We save for later an analysis of the various FCC precedents on which the Commission purported to rely in choosing this mode of analysis.

Before actually applying that analysis, the Commission brushed aside a statutory argument of the competitor LECs. They argued that ISP-bound traffic must be either "telephone exchange service," as defined in 47 U.S.C. § 153(47), or "exchange access," as defined in § 153(16).[18] It could not be the latter, they reasoned, because ISPs do not assess toll charges for the service (*see id.*, "the offering of access ... for the purpose of the origination or termination of telephone toll services"), and therefore it must be the former, for which reciprocal compensation is mandated. Here the Commission's answer was that it has consistently

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18 "Telephone exchange service" is defined as:
(A) service within a telephone exchange, or within a connected system of telephone exchanges within the same exchange area operated to furnish to subscribers intercommunicating service of the character ordinarily furnished by a single exchange, and which is covered by the exchange service charge, or (B) comparable service provided through a system of switches, transmission equipment, or other facilities (or combination thereof) by which a subscriber can originate and terminate a telecommunications service. 47 U.S.C. § 153(47). "Exchange access" is defined as: the offering of access to telephone exchange services or facilities for the purpose of the origination or termination of telephone toll services. *Id.* § 153(16).

treated ISPs (and ESPs generally) as "users of access service," while treating them as end users merely for access charge purposes. *FCC Ruling*, 14 FCC Rcd at 3701 (¶ 17).

Having decided to use the "end-to-end" method, the Commission considered whether ISP-bound traffic is, under this method, in fact interstate. In a conventional "circuit-switched network," the jurisdictional analysis is straightforward: a call is intrastate if, and only if, it originates and terminates in the same state. In a "packet-switched network," the analysis is not so simple, as "an Internet communication does not necessarily have a point of 'termination' in the traditional sense." *FCC Ruling*, 14 FCC Rcd at 3701-02 (¶ 18). In a single session an end user may communicate with multiple destination points, either sequentially or simultaneously. Although these destinations are sometimes intrastate, the Commission concluded that "a substantial portion of Internet traffic involves accessing interstate or foreign websites." *Id.* Thus reciprocal compensation was not due, and the issue of compensation between the two local LECs was left initially to the LECs involved, subject to state commissions' power to order compensation in the "arbitration" proceedings, and, of course to whatever may follow from the Commission's new rulemaking on its own possible ratesetting.

* * *

The issue at the heart of this case is whether a call to an ISP is local or long-distance. Neither category fits clearly. The Commission has described local calls, on the one hand, as those in which LECs collaborate to complete a call and are compensated for their respective roles in completing the call, and long-distance calls, on the other, as those in which the LECs collaborate with a long-distance carrier, which itself charges the end-user and pays out compensation to the

LECs. *See Local Competition Order*, 11 FCC Rcd at 16013 (¶ 1034) (1996).

Calls to ISPs are not quite local, because there is some communication taking place between the ISP and out-of-state websites. But they are not quite long-distance, because the subsequent communication is not really a continuation, in the conventional sense, of the initial call to the ISP. The Commission's ruling rests squarely on its decision to employ an end-to-end analysis for purposes of determining whether ISP traffic is local. There is no dispute that the Commission has historically been justified in relying on this method when determining whether a particular communication is jurisdictionally interstate. But it has yet to provide an explanation why this inquiry is relevant to discerning whether a call to an ISP should fit within the local call model of two collaborating LECs or the long-distance model of a long-distance carrier collaborating with two LECs.

In fact, the extension of "end-to-end" analysis from jurisdictional purposes to the present context yields intuitively backwards results. Calls that are jurisdictionally intrastate will be subject to the federal reciprocal compensation requirement, while calls that are interstate are not subject to federal regulation but instead are left to potential state regulation. The inconsistency is not necessarily fatal, since under the 1996 Act the Commission has jurisdiction to implement such provisions as § 251, even if they are within the traditional domain of the states. *See AT&T Corp.*, 119 S. Ct. at 730. But it reveals that arguments supporting use of the end-to-end analysis in the jurisdictional analysis are not obviously transferable to this context.

In attacking the Commission's classification of ISP-bound calls as non-local for purposes of reciprocal

compensation, MCI WorldCom notes that under 47 CFR § 51.701(b)(1) "telecommunications traffic" is local if it " originates and terminates within a local service area." But, observes MCI WorldCom, the Commission failed to apply, or even to mention, its definition of "termination," namely "the switching of traffic that is subject to section 251(b)(5) at the terminating carrier's end office switch (or equivalent facility) and delivery of that traffic from that switch to the called party's premises." *Local Competition Order*, 11 FCC Rcd at 16015 (¶ 1040); 47 CFR § 51.701(d). Calls to ISPs appear to fit this definition: the traffic is switched by the LEC whose customer is the ISP and then delivered to the ISP, which is clearly the "called party."

In its ruling the Commission avoided this result by analyzing the communication on an end-to-end basis: "The communications at issue here do not terminate at the ISP's local server ..., but continue to the ultimate destination or destinations." *FCC Ruling*, 14 FCC Rcd at 3697 (¶ 12). But the cases it relied on for using this analysis are not on point. Both involved a single continuous communication, originated by an end-user, switched by a long-distance communications carrier, and eventually delivered to its destination. *One, Teleconnect Co. v. Bell Telephone Co.*, 10 FCC Rcd 1626 (1995), *aff'd sub nom. Southwestern Bell Tel. Co. v. FCC*, 325 U.S. App. D.C. 249, 116 F.3d 593 (D.C. Cir. 1997) ("*Teleconnect*"), involved an 800 call to a long-distance carrier, which then routed the call to its intended recipient. The other, *In the Matter of Petition for Emergency Relief and Declaratory Ruling Filed by the Bell-South Corporation*, 7 FCC Rcd 1619 (1992), considered a voice mail service. Part of the service, the forwarding of the call from the intended recipient's location to the voice mail apparatus and service, occurred entirely within the subscriber's state, and thus looked local. Looking "end-to-end," however, the Commission refused to focus on this

portion of the call but rather considered the service in its entirety (*i.e.*, originating with the out-of-state caller leaving a message, or the subscriber calling from out-of-state to retrieve messages). *Id.* at 1621 (¶ 12).

ISPs, in contrast, are "information service providers," *Universal Service Report*, 13 FCC Rcd at 11532-33 (¶ 66), which upon receiving a call originate further communications to deliver and retrieve information to and from distant websites. The Commission acknowledged in a footnote that the cases it relied upon were distinguishable, but dismissed the problem out-of-hand: "Although the cited cases involve interexchange carriers rather than ISPs, and the Commission has observed that 'it is not clear that [information service providers] use the public switched network in a manner analogous to IXCs," *Access Charge Reform Order*, 12 FCC Rcd at 16133, the Commission's observation does not affect the jurisdictional analysis." *FCC Ruling*, 14 FCC Rcd at 3697 n.36 (¶ 12). It is not clear how this helps the Commission. Even if the difference between ISPs and traditional long-distance carriers is irrelevant for jurisdictional purposes, it appears relevant for purposes of reciprocal compensation. Although ISPs use telecommunications to provide information service, they are not themselves telecommunications providers (as are long-distance carriers).

In this regard an ISP appears, as MCI WorldCom argued, no different from many businesses, such as "pizza delivery firms, travel reservation agencies, credit card verification firms, or taxicab companies," which use a variety of communication services to provide their goods or services to their customers. Comments of WorldCom, Inc. at 7 (July 17, 1997). Of course, the ISP's origination of telecommunications as a result of the user's call is instantaneous (although perhaps no more so than a credit

card verification system or a bank account information service). But this does not imply that the original communication does not "terminate" at the ISP. The Commission has not satisfactorily explained why an ISP is not, for purposes of reciprocal compensation, "simply a communications-intensive business end user selling a product to other consumer and business end-users." *Id.*

The Commission nevertheless argues that although the call from the ISP to an out-of-state website is information service for the end-user, it is telecommunications for the ISP, and thus the telecommunications cannot be said to "terminate" at the ISP. As the Commission states: "Even if, from the perspective of the end user as customer, the telecommunications portion of an Internet call 'terminates' at the ISP's server (and information service begins), the remaining portion of the call would continue to constitute telecommunications from the perspective of the ISP as customer." Commission's Br. at 41. Once again, however, the mere fact that the ISP originates further telecommunications does not imply that the original telecommunication does not "terminate" at the ISP. However sound the end-to-end analysis may be for jurisdictional purposes, the Commission has not explained why viewing these linked telecommunications as continuous works for purposes of reciprocal compensation.

Adding further confusion is a series of Commission rulings dealing with a class, enhanced service providers ("ESPs"), of which ISPs are a subclass. *See FCC Ruling*, 14 FCC Rcd at 3689 n.1 (¶ 1). ESPs, the precursors to the 1996 Act's information service providers, offer data processing services, linking customers and computers via the telephone network. *See MCI Telecommunications Corp.*

v. FCC, 313 U.S. App. D.C. 51, 57 F.3d 1136, 1138 (D.C. Cir. 1995).[19] In its establishment of the access charge system for long-distance calls, the Commission in 1983 exempted ESPs from the access charge system, thus in effect treating them like end users rather than long-distance carriers. *See In the Matter of MTS & WATS Market Structure*, 97 F.C.C.2d 682, 711-15 (P 77-83) (1983). It reaffirmed this decision in 1991, explaining that it had "refrained from applying full access charges to ESPs out of concern that the industry has continued to be affected by a number of significant, potentially disruptive, and rapidly changing circumstances." *In the Matter of Part 69 of the Commission's Rules Relating to the Creation of Access Charge Subelements for Open Network Architecture*, 6 FCC Rcd 4524, 4534 (P 54) (1991). In 1997 it again preserved the status quo. *In the Matter of Access Charge Reform*, 12 FCC Rcd 15982 (1997) ("*Access Charge Reform Order*"). It justified the exemption in terms of the goals of the 1996 Act, saying that its purpose was to "preserve the vibrant and competitive free market that presently exists for the Internet and other interactive computer services." *Id.* at 16133 (¶ 344) (quoting 47 U.S.C. § 230(b)(2)).

This classification of ESPs is something of an embarrassment to the Commission's present ruling. As MCI World-Com notes, the Commission acknowledged in the *Access Charge Reform Order* that "given the evolution in [information service provider] technologies and markets since we first established access charges in the early 1980s,

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[19] The regulatory definition states that ESPs offer "services ... which employ computer processing applications that act on the format, content, code, protocol or similar aspects of the subscriber's transmitted information; provide the subscriber additional, different, or restructured information; or involve subscriber interaction with stored information." 47 CFR § 64.702(a).

it is not clear that [information service providers] use the public switched network in a manner analogous to IXCs [inter-exchange carriers]." 12 FCC Rcd at 16133 (¶ 345). It also referred to calls to information service providers as "local." *Id.* at 16132 (¶ 342 n.502). And when this aspect of the *Access Charge Reform Order* was challenged in the 8th Circuit, the Commission's briefwriters responded with a sharp differentiation between such calls and ordinary long-distance calls covered by the "end-to-end" analysis, and even used the analogy employed by MCI WorldCom here — that a call to an information service provider is really like a call to a local business that then uses the telephone to order wares to meet the need. Brief of FCC at 76, *Southwestern Bell v. FCC*, 153 F.3d 523 (8th Cir. 1998) (No. 97-2618). When accused of inconsistency in the present matter, the Commission flipped the argument on its head, arguing that its exemption of ESPs from access charges actually confirms "its understanding that ESPs in fact use interstate access service; otherwise, the exemption would not be necessary." *FCC Ruling*, 14 FCC Rcd at 3700 (¶ 16). This is not very compelling. Although, to be sure, the Commission used policy arguments to justify the "exemption," it also rested it on an acknowledgment of the real differences between long-distance calls and calls to information service providers. It is obscure why those have now dropped out of the picture.

Because the Commission has not supplied a real explanation for its decision to treat end-to-end analysis as controlling, *Motor Vehicle Mfrs. Ass'n of U.S., Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43, 77 L. Ed. 2d 443, 103 S. Ct. 2856 (1983); 5 U.S.C. § 706(2)(A), we must vacate the ruling and remand the case.

There is an independent ground requiring remand — the fit of the present rule within the governing statute. MCI

WorldCom says that ISP-traffic is "telephone exchange service[]" as defined in 47 U.S.C. § 153(16), which it claims "is synonymous under the Act with the service used to make local phone calls," and emphatically not "exchange access" as defined in 47 U.S.C. § 153(47). Petitioner MCI WorldCom's Initial Br. at 22. In the only paragraph of the ruling in which the Commission addressed this issue, it merely stated that it "consistently has characterized ESPs as 'users of access service' but has treated them as end users for pricing purposes." *FCC Ruling*, 14 FCC Rcd at 3701 (¶ 17). In a statutory world of "telephone exchange service" and "exchange access," which the Commission here says constitute the only possibilities, the reference to "access service," combining the different key words from the two terms before us, sheds no light. "Access service" is in fact a pre-Act term, defined as "services and facilities provided for the origination or termination of any interstate or foreign telecommunication." 47 CFR § 69.2(b).

If the Commission meant to place ISP-traffic within a third category, not "telephone exchange service" and not "exchange access," that would conflict with its concession on appeal that "exchange access" and "telephone exchange service" occupy the field. But if it meant that just as ESPs were "users of access service" but treated as end users for pricing purposes, so too ISPs are users of exchange access, the Commission has not provided a satisfactory explanation why this is the case. In fact, in *In the Matter of Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended*, 11 FCC Rcd 21905, 22023 (¶ 248) (1996), the Commission clearly stated that "ISPs do not use exchange access." After oral argument in this case the Commission overruled this determination, saying that "non-carriers may be purchasers of those services." *In the Matter of Deployment of Wireline Services Offering Advanced*

Telecommunications Capability, FCC 99-413, at 21 (¶ 43) (Dec. 23, 1999). The Commission relied on its pre-Act orders in which it had determined that non-carriers can use "access services," and concluded that there is no evidence that Congress, in codifying "exchange access," intended to depart from this understanding. *See id.* at 21-22 (¶ 44). The Commission, however, did not make this argument in the ruling under review.

Nor did the Commission even consider how regarding noncarriers as purchasers of "exchange access" fits with the statutory definition of that term. A call is "exchange access" if offered "for the purpose of the origination or termination of telephone toll services." 47 U.S.C. § 153(16). As MCI WorldCom argued, ISPs provide information service rather than telecommunications; as such, "ISPs connect to the local network 'for the purpose of' providing information services, not originating or terminating telephone toll services." Petitioner MCI WorldCom's Reply Br. at 6.

The statute appears ambiguous as to whether calls to ISPs fit within "exchange access" or "telephone exchange service," and on that view any agency interpretation would be subject to judicial deference. *See Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 842-43, 81 L. Ed. 2d 694, 104 S. Ct. 2778 (1984). But, even though we review the agency's interpretation only for reasonableness where Congress has not resolved the issue, where a decision "is valid only as a determination of policy or judgment which the agency alone is authorized to make and which it has not made, a judicial judgment cannot be made to do service." *SEC v. Chenery Corp.*, 318 U.S. 80, 88, 87 L. Ed. 626, 63 S. Ct. 454 (1943). *See also Acme Die Casting v. NLRB*, 307 U.S. App. D.C. 21, 26 F.3d 162, 166 (D.C. Cir. 1994); *Leeco, Inc. v. Hays*, 296 U.S. App. D.C. 119, 965 F.2d 1081, 1085 (D.C. Cir. 1992); *City of Kansas*

City v. Department of Housing and Urban Development, 287 U.S. App. D.C. 365, 923 F.2d 188, 191-92 (D.C. Cir. 1991).

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Because the Commission has not provided a satisfactory explanation why LECs that terminate calls to ISPs are not properly seen as "terminating ... local telecommunications traffic," and why such traffic is "exchange access" rather than "telephone exchange service," we vacate the ruling and remand the case to the Commission. We do not reach the objections of the incumbent LECs — that § 251(b)(5) preempts state commission authority to compel payments to the competitor LECs; at present we have no adequately explained classification of these communications, and in the interim our vacatur of the Commission's ruling leaves the incumbents free to seek relief from state-authorized compensation that they believe to be wrongfully imposed.

So ordered.